TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1938

No. 487

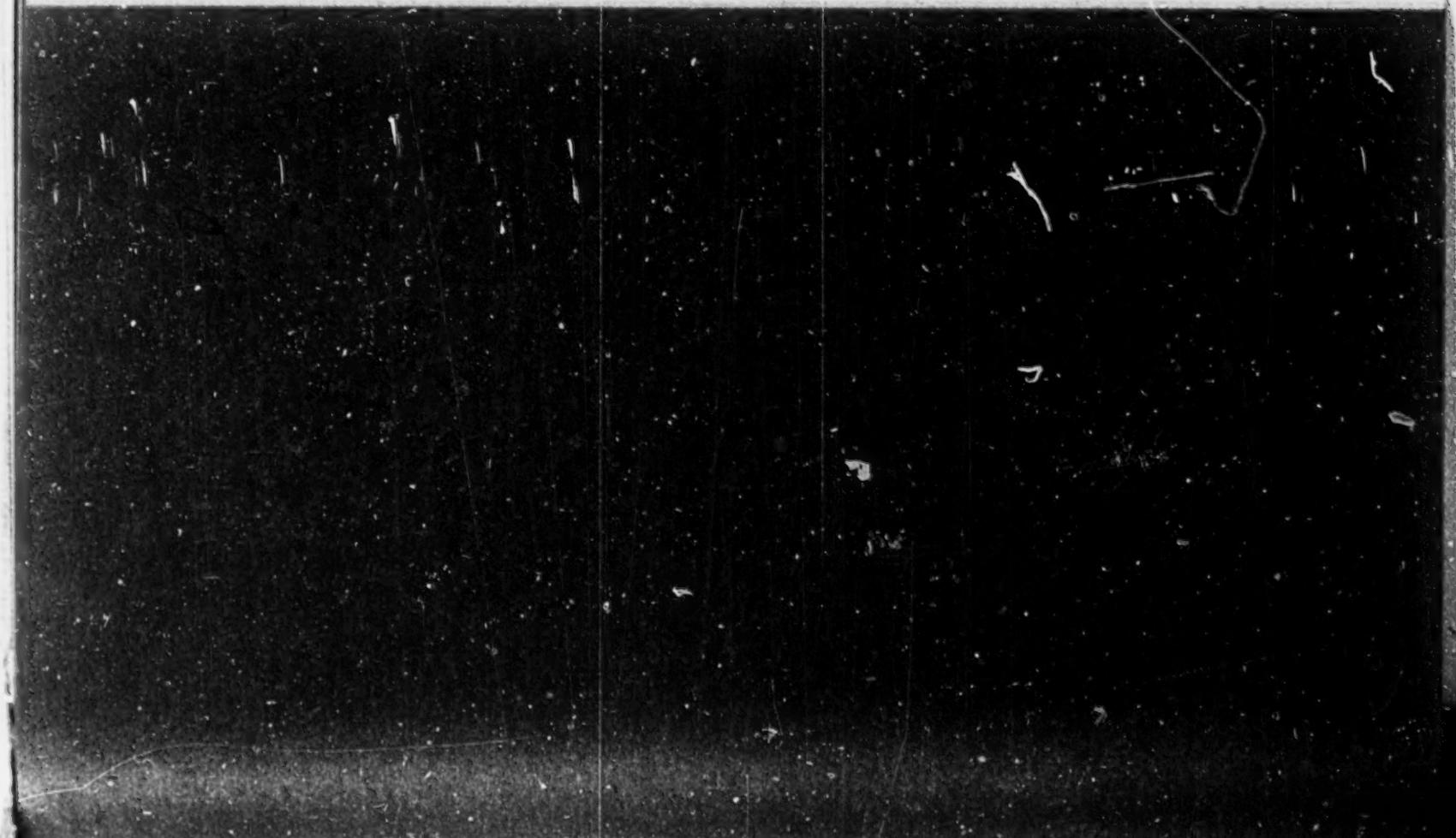
GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

PENNSYLVANIA WATER & POWER COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI, FILED NOVEMBER 23, 1938
CERTIORARI GRANTED JANUARY 3, 1939



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1 Before United States Board of Tax Appeals

Docket No. 56720

PENNSYLVANIA WATER & POWER COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Taxpayer: Edward J. Stegman, (withdrawn), Edwin M. Sturtevant, Clyde T. Warren. For Commissioner: F. Schlosser, Esq., Wm. E. Davis, Esq.

Docket entries

Apr. 18, 1931—Petition received and filed. Taxpayer notified. (Fee paid)

Apr. 18, 1931—Copy of petition served on General Counsel.

May 27, 1931—Motion for order to show cause (imperfect petition), filed by General Counsel.

June 3, 1931—Hearing set June 24, 1931 on motion.

June 24, 1931—Hearing had before Mr. Smith on motion. Denied. Usual time to answer.

June 24, 1931—Order denying motion and that respondent be given usual time to answer or move, entered.

2 Oct. 17, 1931—Answer filed by General Counsel.

Oct. 20, 1931—Copy of answer served on taxpayer. General Calendar.

Dec. 3, 1931—Notice of appearance of Edwin M. Sturtevant as counsel filed.

Jan. 11, 1933—Hearing set Feb. 9, 1933.

Feb. 1, 1933—Motion for continuance filed by taxpayer. 2/4/33. Granted to 4/20/33.

Feb. 1, 1933—Notice to serve all papers on Mr. Edwin M. Sturtevant filed by Treasurer of taxpayer.

Feb. 2, 1933—Notice of withdrawal of Edward J. Stegman as counsel filed.

Apr. 5, 1933—Motion to place on the Reserve Calendar filed by taxpayer. 4/7/33. Granted to Fall 1933.

Oct. 2, 1936—Hearing set Nov. 30, 1936.

Nov. 30, 1936—Hearing had before Mr. A. J. Mellott, Div. 11. Stipulation of facts and exhibits 1, 2, 3, & 4 filed. Petitioner's brief due 1/14/37. Respondent's 2/13/37. Pet.'s reply Mar. 1, 1937.

Dec. 8, 1936—Transcript of hearing of Nov. 30, 1936, filed.

Dec. 10, 1936—Brief filed by taxpayer. 12/10/36 copy served.

Feb. 6, 1937—Brief filed by General Counsel.

Aug. 24, 1937—Opinion rendered, Arthur J. Mellott, Div. 11. Judgment will be entered under Rule 50

3 Sept. 24, 1937—Notice of settlement filed by General Counsel.

Sept. 27, 1937—Hearing set Oct. 20, 1937 on settlement.

Oct. 4, 1937—Motion to substitute the attached recomputation in place of that filed Sept. 24, 1937, filed by General Counsel.

Oct. 9, 1937—Consent to substituted computation filed by taxpayer.

Oct. 16, 1937—Decision entered, Div. 15, Eugene Black.

Nov. 3, 1937—Notice of appearance of Clyde T. Warren as counsel filed.
Dec. 22, 1937—Petition for review by United States Circuit Court of Appeals, Third Circuit, with assignments of error filed by taxpayer.
Dec. 22, 1937—Proof of service filed by taxpayer.
Dec. 29, 1937—Agreed statement of evidence lodged.
Dec. 29, 1937—Agreed præcipe filed.
Dec. 20, 1937—Agreed statement of evidence approved and ordered filed.

4 Before United States Board of Tax Appeals

Docket No. 56720

PENNSYLVANIA WATER AND POWER COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition

Filed April 18, 1931

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice IT:AR:C-8 DBH-60D, dated February 18, 1931, and as a basis of its proceeding alleges as follows:

1. The petitioner, Pennsylvania Water and Power Company, is a corporation, organized under the laws of Pennsylvania, having its principal office at Holtwood, Pennsylvania.

2. The notice of deficiency, a copy of which is attached hereto and marked "Exhibit A," was mailed to the petitioner on February 18, 1931.

3. The taxes in controversy are income taxes for the calendar year 1928 in the amount of $87,351.57.

4. The determination of the tax set forth in the said notice of deficiency is based upon the following errors:

5 The disallowance of unamortized bond discount and expense together with premiums paid to retire bonds which were called in on March 1, 1928, as follows:

A. The unamortized portion (as of March 1, 1928) of the discount and expense on the $3,000,000.00 par value of the petitioner's 5½ Per Cent. Bonds, originally due October 1, 1953, on their retirement on March 1, 1928	$203,573.88
B. The premium paid upon the retirement of the petitioner's 5½ Per Cent. Bonds on March 1, 1928	195,000.00
C. The amortization of discount and expense applicable to the Holtwood Power Company Bonds for the months of January and February, 1928	904.42
D. The unamortized portion (as of March 1, 1928) of the discount and expense on the $2,750,000.00 par value Holtwood Power Company 6 Per Cent. Bonds, originally due September 1, 1954, upon the retirement of said bonds on March 1, 1928	144,255.10
E. Premium paid upon the retirement of the Holtwood Power Company Bonds, March 1, 1928	192,500.00
Total	$736,233.40

	F. Less deduction of additional amortization of bond discount, premium and expenses allowed by the Commissioner as a result of prorating over the life of the 4½ Per Cent. Bonds (issued by Pennsylvania Water and Power Company as of March 1, 1928, the proceeds of which were used in part to retire petitioner's 5½ Per Cent. Bonds) the bond discount, premium and expenses of the 5½ Per Cent. Bonds disallowed as a deduction for the year 1928 in Sections A and B	8,303.63
	Total disallowed	$727,929.77

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

PETITIONER'S 5½ PER CENT. BONDS

(1) The petitioner was incorporated under the laws of the State of Pennsylvania on January 13, 1910. The petitioner was from 1910 to 1928, and is, engaged in the business of producing, transmitting and selling electric power, in the States of Maryland and Pennsylvania.

(2) The petitioner sold to the public a total of $3,000,000 par value of its 5½ per cent. bonds, originally due October 1, 1953 as follows:— In November 1923, $2,000,000; in July 1924, $1,000,000, and received, therefor, a total of $2,767,500.

(3) The difference between the par value of these bonds ($3,000,000) and the amount received for them ($2,787,500), amounting to $212,500 was entered on the petitioner's books as "Unamortized Bond Discount & Expense." Expenses in the amount of $23,868.20 were incurred by the Petitioner in connection with the floating of these bonds, which amount was added to the "Unamortized Bond Discount and Expense" account. During each of the years 1923 to 1927, inclusive, and for the period January 1 to February 29, 1928, an amortization of the bond discount and expense referred to above at the rate of 3⅓ per cent. per year, was used as a deduction in petitioner's consolidated income tax returns for the years mentioned, and was approved by the Commissioner or his agent. The total of the amounts so used up to and including February 29, 1928 was $32,794.32, leaving a balance not so used of $203,573.88.

(4) On March 1, 1928, the petitioner issued its 4½ per cent. bonds, due March 1, 1968, in the amount of $6,000,000 par value.

(5) On March 1, 1928, the petitioner called in for payment all of its outstanding 5½ per cent. bonds, of a total par value of $3,000,000, paying therefor par plus a premium of 6½ per cent., or a total of $3,195,000.

(6) Upon the retirement of these bonds the unamortized balance of the discount and expenses applicable thereto, in the amount of $203,573.88, became valueless to the petitioner, and was deductible as an ordinary and necessary business expense in the petitioner's 1928 income tax return.

(7) The premium paid ($195,000) to retire the petitioner's 5½ per cent. bonds was an ordinary and necessary business expense of the petitioner in 1928.

(8) The Commissioner has disallowed as deductions for 1928 the unamortized balance of the bond discount and expense applicable to the petitioner's 5½ per cent. bonds as of March 1, 1928, in the amount of $203,573.88, and the premium of $195,000 paid to retire these bonds, and holds that these items are additional cost of floating the new issue of 4½ per cent. bonds.

8 (9) The Commissioner has allowed as an additional deduction 10/12 of 1/40 of the amounts disallowed in Paragraph 8, as amortization of additional discount and expense on the new issue of 4½ per cent. bonds for the period March 1 to December 31, 1928.

HOLTWOOD POWER COMPANY BONDS

(10) Prior to 1924, all of petitioner's power was produced by water-power at a hydro-electric plant located on the Susquehanna River at Holtwood, Pennsylvania. In 1924 the petitioner found it necessary to augment its hydro-electric power plant by a steam-driven power plant, and it organized the Holtwood Power Company to carry on this activity. The Holtwood Power Company was accordingly incorporated on August 9, 1924, under the laws of the State of Pennsylvania, with an authorized capital of $1,500,000.

(11) The entire capital stock of the Holtwood Power Company was subscribed for by, and issued to, the petitioner between August, 1924 and December, 1924. The petitioner paid said Holtwood Power Company $1,500,000 in cash and property, between August, 1924 and December, 1924, in payment of this stock.

(12) During the entire life of the Holtwood Power Company, all of its capital stock was owned and held by the petitioner. The petitioner had at all times complete and absolute control of the Holtwood Power Company. The operations of the Holtwood Power Company were included in the petitioner's consolidated income tax returns during its entire life. The petitioner entered into an agreement, attached hereto as Exhibit "B", with the Holtwood Power Company, dated August 26, 1924, reading in part as follows:

9 "2. The Steam Company agrees that (subject to its obligations as a public utility) it will deliver, on the order of the Power Company, electric power up to the full capacity of the Steam Company's plant.

"3. The Power Company shall pay to Steam Company as compensation hereunder a sum sufficient to provide Steam Company the following:

"(a) All costs of management, operation, and maintenance.

"(b) An allowance for setting up depreciation, obsolescence, and renewal and replacement reserves or any of them in accordance with the standards accepted by the Pennsylvania Public Service Commission and agreed to by the parties hereto.

"(c) A sum to provide for amortization of debt, discount, and security issue expense.

"(d) A sum sufficient to provide a net return of eight per cent. annually upon the par value of its securities including its paid up stock.

"(e) Payments to be made by Power Company under Section a, paragraph 3, above, shall include any and all sums necessary for the purpose of defraying the expenses of maintaining the corporate organization of the Steam Company; the expenses attending the issuing, registration, and transfer of the capital stock and bonds of the Steam Company, now or hereafter issued and outstanding, and all interest on its bonded or other indebtedness at any time outstanding or existing, as and when said several interest payments may become
10 due and payable; sinking fund requirements of its first mortgage or other bonds, in accordance with the provisions of the mortgage or deed of trust securing such bonds; all Federal, State, Municipal and other taxes, charges, licenses, and assessments, now or hereafter lawfully imposed upon the Steam Company or for which it may in any manner be liable or chargeable on account of its corporate existence, its franchises, property, real or personal, business, earnings, bonds, capital stock, dividends, or profits and any sum which shall hereafter be levied or assessed on any shareholder of the Steam Company or upon its share by way of direct tax upon said share or the income thereof, which the Steam Company shall or may be required to pay on behalf of or retain from any such shareholder or bondholder; all fire, storm, lightning, accident, compensation, public liability, or other insurance premiums which the Steam Company may be required or deem advisable to carry; all legal expenses and other expenses whatsoever from time to time as the same may arise not otherwise specifically covered by the terms of this agreement. The intent and purpose of these provisions being that the Power Company shall at all times pay or provide for the payment of every obligation and expense of the Steam Company in order to enable the latter to realize a net return of eight per cent. annually upon the par value of all of its securities at any time outstanding."

11 The only purpose of the organization and existence of the Holtwood Power Company was to enable the petitioner to engage in the steam-power business. The Holtwood Power Company was in effect merely a part of the petitioner's plant.

(13) On or about September 1, 1924, an issue of 30-year 6 per cent. bonds of a total par value of $2,750,000 was sold to the public by the Holtwood Power Company for a total of $2,612,500. These bonds were in effect the petitioner's obligations at the moment of their issue, and at all times subsequent thereto.

(14) The difference between the par value ($2,750,000) of said bonds and the amount received for them ($2,612,500), amounting to $137,500 was entered on the books of the Holtwood Power Company as "Unamortized Bond Discount and Expense." Expenses were incurred in connection with the floating of these bonds, in the

amount of $25,249.87, which amount was added to the "Unamortized Bond Discount and Expense" account. During each of the years 1924, 1925, 1926, and 1927 an amortization of the bond discount and expense at the rate of 3⅓ per cent. of the total per year was used as a deduction in petitioner's consolidated income tax returns for the years mentioned and was approved by the Commissioner or his agent. The total of the amounts so used to and including the taxable year 1927 was $17,590.35, leaving a balance not so used of $145,159.52 at December 31, 1927.

(15) In December 1927 the Holtwood Power Company was merged with the petitioner. The petitioner surrendered its stock in the Holtwood Power Company to it for cancellation as
12 of December 1, 1927, and in exchange therefor received all the assets of the Holtwood Power Company and assumed all of its liabilities.

(16) Among the assets received by petitioner from the Holtwood Power Company were "Unamortized Bond Discount and Expense" in the amount of $145,611.73, and among the liabilities assumed were "Mortgage Bonds Payable" in the amount of $2,750,000. In January 1928 the Holtwood Power Company ceased to exist.

(17) Upon the merger referred to above the assets and liabilities of the Holtwood Power Company became in law and fact what they had already been in effect—the assets and liabilities of the petitioner. The merger was a change in form only; it was not a change in substance. The degree of control and ownership by the petitioner of the Holtwood Power Company assets and liabilities was not changed by the merger. The petitioner became the legal successor to the Holtwood Power Company and, as such, succeeded to all the rights and obligations of the Holtwood Power Company, including the right to deduct in its income tax returns any items which the Holtwood Company had the right to deduct, and the obligation to redeem the bonds at par at maturity, with the option to retire said bonds at premium before the date of maturity.

(18) On March 1, 1928, the petitioner, pursuant to its option, called in for retirement all of the outstanding 6 per cent. bonds of the Holtwood Power Company, of a total par value of $2,750,000, paying therefor par plus a premium of 7 per cent., or a total of $2,942,500.

(19) The payment of this premium was, under the terms of the indenture, necessary in order to retire these bonds.

13 (20) These bonds of the Holtwood Power Company were, at the time of their retirement, the direct obligations of the petitioner.

(21) Upon the retirement of these bonds the unamortized balance of the discount and expenses applicable thereto, in the amount of $144,255.10, became valueless to the petitioner, and was deductible

as an ordinary and necessary business expense in petitioner's 1928 income tax return.

(22) The premium paid to retire the Holtwood Power Company bonds ($192,500) was an ordinary and necessary business expense of the petitioner in 1928 and was deducted in petitioner's income tax return for that year.

(23) The petitioner used as a deduction in its 1928 income tax return an amortization of bond discount and expense applicable to the bonds of the Holtwood Power Company for the period January 1, 1928, to February 29, 1928. This deduction amounting to $904.42, was an ordinary and necessary business expense of the petitioner in 1928.

(24) The Commissioner has disallowed as deductions for 1928:

(a) The unamortized balance of the bond discount and expense applicable to the bonds of the Holtwood Power Company as of March 1, 1928, in the amount of $144,255.10;

(b) The premium of $192,500 paid to retire the Holtwood Power Company bonds;

(c) The amortization of discount and expense, applicable to the Holtwood Power Company bonds, for the period January 1 to February 29, 1928, in the amount of $904.42.

6. Wherefore, the petitioner prays that this Board may hear the proceedings and determine that:

(1) The petitioner succeeded to all the rights and obligations of the Holtwood Power Company, and was entitled to treat its bonds payable, and unamortized discount and expenses as its own.

(2) The unamortized balance of Holtwood Power Company's bond discount and expense as of March 1, 1928, the amortization thereof for January and February, 1928, and the premium paid to retire the Holtwood bonds, were ordinary and necessary business expenses of the petitioner in 1928.

(3) The unamortized balance of discount and expense, as of March 1, 1928, applicable to petitioner's 5½ per cent bonds, and the premium paid to retire these bonds were ordinary and necessary business expenses in 1928.

(4) That there has been an over-assessment of $727,929.77 in income, or $87,351.57 in tax, for the year 1928.

PENNSYLVANIA WATER AND POWER COMPANY,
[SEAL] By JAS. L. RINTOUL, *Treasurer.*
EDWARD J. STEGEMAN,
Counsel for Petitioner,
1214 Continental Bldg., Baltimore, Maryland.
EDWIN M. STURTEVANT,
Counsel for Petitioner,
1707 Lexington Bldg., Baltimore, Maryland.

[*Duly sworn to by James L. Rintoul; jurat omitted in printing.*]

16 *Exhibit A to petition*

TREASURY DEPARTMENT,
Washington, February 18, 1931.

PENNSYLVANIA WATER AND POWER COMPANY,
Lexington Building, Baltimore, Maryland.

SIRS: You are advised that the determination of your tax liability for the year 1928 discloses a deficiency of $86,508.25, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNET,
Commissioner.
By J. C. WILMER,
Deputy Commissioner.

Enclosures:
Statement.
Form 882.
Form 870.
Schedules 1 to 7, inclusive.

17 IT:AR:C-8.
DBH-60D.

STATEMENT

Companies included in the Consolidation:	Returns examined for the years
Parent Company:	
Pennsylvania Water and Power Company, Lexington Building, Baltimore, Maryland	1928
Subsidiary Companies:	
The Baltimore Electro Alloys Company, Lexington Building, Baltimore, Maryland	1928
Holtwood Coal Company, Lexington Building, Baltimore, Maryland	1928
McCall Ferry Company, Lexington Building, Baltimore, Maryland	1928
Susquehanna Falls Power Company, Lexington Building, Baltimore, Maryland	1928
Susquehanna Canal and Power Company, Lexington Building, Baltimore, Maryland	1928
Susquehanna Transmission Company of Maryland, Lexington Building, Baltimore, Maryland	1928
Susquehanna Transmission Company of Pennsylvania, Lexington Building, Baltimore, Maryland	1928
18 Susquehanna Storage, Lake and Power Company, Lexington Building, Baltimore, Maryland	1928
York Furnace Electric Company, Lexington Building, Baltimore, Maryland	1928

TAX LIABILITY

PENNSYLVANIA WATER AND POWER COMPANY

Year	Tax Liability	Tax Assessed	Deficiency
1928	$261,314.13	$174,805.88	$86,508.25

The adjustments resulting in the above deficiency are set forth in a revenue agent's report, a copy of which you have and schedules attached hereto.

In determining the above deficiency careful consideration has been given to the contentions raised in your protest and at a conference in this office on February 2, 1931, to the adjustment for bond discount and expenses. Your contentions must, however, be denied.

The entire tax liability has been allocated to the Pennsylvania Water and Power Company in accordance with allocation agreement on file in this office.

A carbon of this letter has been mailed to Mr. Edward J. Stegman, 1214 Continental Building, Baltimore, in accordance with a power of attorney, running to him which is on file in this office.

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SCHEDULE 1

PENNSYLVANIA WATER AND POWER COMPANY—YEAR ENDED DECEMBER 31, 192

NET INCOME

Net income as disclosed by return		$1,406,237.3
As corrected		2,127,139.4
Net adjustment		720,902.0
Unallowable deductions and additional income:		
(a) Bond discount and expenses—adjustment	$727,929.77	
(b) Donations	1,000.00	
Total		728,902.7
Non-taxable income and additional deduction:		
(c) Taxes—adjustment		8,027.7
Net adjustment as above		720,902.0

SCHEDULE 2

EXPLANATION OF ITEMS CHANGED

(a) As shown in Schedule L of your return bond discount in th amount of $789,949.81 has been deducted. An analysis of this deduc tion discloses that it consists of the following:

1. Amortization of bond discount and expenses—first mortgage 5% gold bonds	839,100.3
2. Loss on retirement of $96,000.00 par value—first mortgage 5% gold bonds	6,868.4
3. Unextinguished expense on above bonds retired	244.1
4. Amortization of bond discount and expenses—first refunding 5½% gold bonds	1,328.2
5. Unamortized bond discount and expense—first refunding 5½% gold bonds, retired March 1, 1928	203,573.8
6. Premium paid to retire above bonds	195,000.0
7. Amortization of bond discount and expenses—Holtwood Power Company first mortgage 6% gold bonds	904.4
8. Unamortized bond discount and expenses—Holtwood Power Company bonds retired March 1, 1928	144,255.1
9. Premium paid to retire Holtwood Power Company bonds	192,500.0
10. Amortization of bond discount and expense—first refunding 4½% gold bonds, issued March 1, 1928	6,177.2
Total	789,949.8

Items 1, 2, 3, and 4 are found to be correct and allowed.

Items 5 and 6, representing unamortized bond discount and expense of the First Refunding 5½% gold bonds and the premium paid to re tire said bonds are held to be additional cost of issuing Series B firs refunding 4½% gold bonds, and not a deductible expense in the yea in which the old bonds were retired. The new issue was floated for th specific purpose of retiring the 5½% bonds, and the benefit derive from the transactions are held to extend ratably over the life of th new bond issue.

Items 7, 8, and 9 are disallowed. This office holds that the unamor tized bond discount and expenses on bonds of a predecessor compan are not deductible by the successor corporation for the reason that th

20 latter company in assuming the liabilities of the former ha taken over the contractual obligation to redeem the bonds at

21 stipulated price, usually par or greater and no gain or loss i

derived or sustained by the successor corporation unless the obligation is liquidated at a lesser or greater amount than the stipulated price. A company selling a $100.00 bond at $95.00 redeemable at par has a prospective loss of $5.00 which is deductible ratably over the life of the bond, but a successor corporation assuming the bond at $100.00 and redeeming the same at $100.00 has sustained no loss. In your case the Holtwood Power Company bonds were callable at $107.00 and are presumed to have been taken over by your company at that figure, and as the bonds were redeemed at $107.00 no loss has been sustained by your company, either as a deductible expense in the year the bonds were redeemed or as additional cost of floating the new issue to retire them.

Item 10 is allowed in full and in addition thereto a further deduction resulting from the additional costs outlined above are allowed as follows:

Par value of first refunding 4½% gold bonds		$6,000,000.00
Selling price		5,730,000.00
Discount		$270,000.00
Direct expenses		26,507.37
Unamortized discount and expenses—first refunding 5½% gold bonds		203,573.88
Premium paid to retire above bonds		195,000.00
Total bond discount and expenses		$695,081.25
Life of bonds 40 years.		
Amortization of bond discount and expense applicable to 1928 (10 months)		$14,480.86
Deducted		6,177.23
Additional deduction		$8,303.63
Bond discount deducted on return		$789,949.81
2 Allowed:		
Amortization of discount and expense—first mortgage 5% gold bonds	$39,100.36	
Loss on retirement of $96,000 first mortgage 5% gold bonds (see below)	6,836.45	
Unextinguished expense on above bonds retired	244.15	
Amortization of bond discount and expenses—first refunding 5½% gold bonds retired March 1, 1928	1,320.22	
Amortization of bond discount and expenses—first refunding 4½% gold bonds issued March 1, 1928	14,480.86	$82,020.04
Disallowed		$727,929.77

LOSS ON BONDS RETIRED

Amount paid to acquire bonds		$90,522.20
Selling price	$88,224.00	
Discount taken up	4,429.75	92,653.75
Loss		$6,868.45

(b) Donations are not allowable deductions from gross income. Article 262, Regulations 74.

(c) Taxes applicable to the year 1928 have been allowed as a deduction.

Taxes paid and accrued applicable to 1928	$116,873.29
Taxes deducted on return	108,845.57
Additional deduction	8,027.72

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SCHEDULE 3

THE BALTIMORE ELECTRO ALLOYS COMPANY—YEAR ENDED DECEMBER 31, 1928

NET INCOME

Net income as disclosed by return	$33,852.9
As corrected	No chang

SCHEDULE 4

HOLTWOOD COAL COMPANY

NET INCOME

Net income as disclosed by return	$9,391.4
As corrected	No chang

SCHEDULE 5

MCCALL FERRY COMPANY

NET INCOME

Net income as disclosed by return	$7,233.8
As corrected	No chang

SCHEDULE 6

PENNSYLVANIA WATER AND POWER COMPANY

CONSOLIDATED NET INCOME

Net income as corrected:		
Pennsylvania Water and Power Company	$2,127,139.44	
The Baltimore Electro Alloys Company	33,852.97	
Holtwood Coal Company	9,391.48	
McCall Ferry Company	7,233.87	
Susquehanna Falls Power Company	----------	
Susquehanna Canal and Power Company	----------	
Susquehanna Transmission Company of Maryland	----------	
Susquehanna Transmission Company of Pennsylvania	----------	
Susquehanna Storage Lake and Power Company	----------	
York Furnace Electric Company	----------	
Consolidated net income		$2,177,617.76

SCHEDULE 7

COMPUTATION OF TAX

INCOME TAX

Net income for taxable year	$2,177,617.76
Income tax at 12%	261,314.13
Total previously assessed	174,805.88
Additional tax to be assessed	86,508.25

25 Before United States Board of Tax Appeals

Answer

Filed October 17, 1931

The Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits, denies, avers, and alleges as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the calendar year 1928. Denies that the amount in controversy is as alleged in paragraph 3 of the petition.

4. Admits that in his notice of deficiency the Commissioner disallowed a net amount of $727,929.77 claimed on petitioner's income tax return as unamortized bond discount and expense and premiums paid upon the retirement of bonds. Denies that such action constituted error. Avers (in the alternative) that the Commissioner erred in allowing any amount as a deduction on account of unamortized discount and expense and premium in connection with any bonds issued prior to 1928.

5 (1) Admits that the petitioner was incorporated under the laws of the State of Pennsylvania. Admits that the petitioner was in 1928, and is, engaged in the business of producing, transmitting, and selling electric power in the States of Maryland and Pennsylvania. Alleges that petitioner was formed as the result of the merger mentioned in subparagraph (15) of paragraph 5 of the petition.

26 (2) Admits that prior to 1928 a total of $3,000,000 face value of 5½ per cent. bonds originally due October 1, 1953, had been issued by a corporation of the same name as petitioner and that the issuing corporation received for said bonds a total of $2,787,500.

(3) Admits that the difference between the par value of these bonds ($3,000,000) and the amount received for them ($2,787,500), amounting to $212,500, was entered on said corporation's books as unamortized bond discount and expense. Admits that expenses in the amount of $23,868.20 were incurred by said corporation in connection with the floating of these bonds, which amount was added to the unamortized bond discount and expense account. Admits that petitioner continued the use of the same books and that the unamortized bond discount and expense on these bonds as disclosed by said books at the close of business February 29, 1928, was $203,573.88.

(4) Admits that on March 1, 1928, the petitioner issued its 4½ per cent. bonds due March 1, 1968, in the amount of $6,000,000 par value. Avers that the purpose for which said bonds were issued was the refunding of the 5½ per cent. bonds above mentioned, and the 6 per cent. bonds of the Holtwood Power Company assumed by petitioner.

Avers that the proceeds of the sale of the new 4½ per cent. bond iss were used in their entirety to retire the bond issues mentioned in t preceding sentence.

(5) Admits that on March 1, 1928, the petitioner called in for pa ment all of the above-mentioned outstanding 5½ per cent. bonds of total par value of $3,000,000, paying therefor a total of $3,195,000.

(6) Denies each and every allegation of fact, if any, contained i subparagraph (6) of paragraph 5 of the petition.

27 (7). Denies each and every allegation of fact, if any, co tained in subparagraph (7) of paragraph 5 of the petition.

(8). Admits that the Commissioner has disallowed the unamortize balance of the bond discount and expense above mentioned amountin to $203,573.88, and the premium of $195,000 paid at the time of th retirement of said 5½ per cent. bonds. Admits that the responde held that said items constituted a part of the cost incurred in co nection with the issuance by petitioner on March 1, 1928, of $6,000,0 par value 4½ per cent. bonds due March 1, 1968.

(9). Admits that the Commissioner has allowed as an additiona deduction 10/12 of 1/40 of the unamortized discount amounting t $203,573.88 and premium of $195,000 as amortization of discount an expense on the new issue of 4½ per cent. bonds, as shown in detail o page 3 of the statement attached to the deficiency letter.

(10). Admits that the Holtwood Power Company was a corpora tion organized prior to 1927 under the laws of Pennsylvania. Denie each and every other allegation of fact contained in subparagraph (10) of paragraph 5 of the petition.

(11). Denies each and every allegation of fact contained in sub paragraph (11) of paragraph 5 of the petition.

(12). Denies each and every allegation of fact contained in sub paragraph (12) of paragraph 5 of the petition.

(13). Admits that in the year 1924 the Holtwood Power Company issued its 30 year 6 per cent. bonds of a total par value of

28 $2,750,000 for the sum of $2,612,500. Denies each and every other allegation of fact contained in subparagraph (13) of paragraph 5 of the petition.

(14). Admits that the difference between the par value ($2,750,000) of said bonds and the amount received for them ($2,612,500), amount ing to $137,500, was entered on the books of the Holtwood Power Company as unamortized bond discount and expense. Admits that expenses were incurred in connection with the floating of these bonds in the amount of $25,249.87, which amount was entered to the un amortized bond discount and expense account on the Holtwood Power Company books. Says that the remaining allegations contained in subparagraph (14) of paragraph 5 of the petition are immaterial, and therefore denies the same.

(15). Admits that about the end of the year 1927 or the beginning of 1928 the petitioner in connection with a certain merger acquired

all of the assets of the Holtwood Power Company, and in part consideration therefor assumed all of the liabilities of said company.

(16). Admits that among the liabilities of the Holtwood Power Company which were so assumed by the petitioner were the bonds payable in the face amount of $2,750,000. Denies all other allegations contained in subparagraph (16) of paragraph 5 of the petition.

(17). Denies each and every allegation of fact, if any, contained in subparagraph (17) of paragraph 5 of the petition.

(18). Admits that on March 1, 1928, the petitioner called in for retirement all of the outstanding 6 per cent. bonds issued by the Holtwood Power Company. Admits that the petitioner paid the sum of $2,942,500 in connection with the retirement of these bonds.

(19). Admits all the allegations of fact contained in subparagraph (19) of paragraph 5 of the petition.

(20). Admits all the allegations of fact contained in subparagraph (20) of paragraph 5 of the petition. Alleges that the obligation to pay the premium of 7 per cent. on said bonds was also, at the time of their retirement, the direct obligation of the petitioner, and that said obligations were assumed as part consideration for the acquisition of the assets of Holtwood Power Company.

(21). Denies each and every allegation of fact, if any, contained in subparagraph (21) of paragraph 5 of the petition.

(22). Admits that petitioner deducted said item of $192,500 in its income tax return for 1928, but denies each and every other allegation of fact contained in subparagraph (22) of paragraph 5 of the petition.

(23). Admits that the petitioner claimed a deduction on its income tax return for the year 1928 of $904.42 as amortization of bond discount and expense applicable to the bonds of the Holtwood Power Company for the period January 1, 1928, to February 29, 1928. Denies the remaining allegations contained in subparagraph (23) of paragraph 5 of the petition.

(24). Admits that the Commissioner disallowed as deductions for 1928 the amounts referred to in subparagraph (24) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation contained in the taxpayer's petition not hereinbefore admitted, qualified or denied.

7. The respondent alleges in the alternative (in the event the Board does not sustain the action of the Commissioner in disallowing the amount of the unamortized bond discount and expense and the premium paid on the retirement of the bonds of the Holtwood Power Company) that said unamortized bond discount and expense and said premium are not deductible in their entirety in computing petitioner's net taxable income for the year 1928 for the reason that the amount of said items constituted a capital expenditure or a deferred expense in connection with the issuance of the new bonds, and should be amortized over the life of the bonds which petitioner issued on March 1, 1928.

8. Respondent further alleges in the alternative (in the event it
found and held that petitioner was not organized in 1910 but w
formed as the result of the merger of a prior corporation of the sa
name with the Holtwood Power Company) that petitioner acquire
the assets of said prior corporation of the same nam and as pa
consideration therefor assumed all the outstanding bonds of said pri
corporation, including the above-mentioned 5½ per cent. bonds du
October 1, 1953, of the total face value of $3,000,000; that petitioner di
not acquire as an asset any unamortized discount and expense on ac
count of any bonds of said prior corporation; that petitioner als
assumed as part consideration for the acquisition of said assets th
obligation to pay the 6½ per cent. premium as and when said bond
should be called for retirement; that all amounts in reference to an
bonds of said prior corporation constituted a part of the cost of th
assets so acquired, and no part thereof, whether principal, discount
expense, or premium, constituted an ordinary and necessary expens
of petitioner for the year 1928, or was otherwise deductible in com-
puting petitioner's net taxable income for 1928; that the Commissioner
erroneously allowed as deductions all amounts set forth on page 3
of the statement attached to the deficiency letter except the item
31 of $6,177.23 claimed and allowed as amortization of the dis-
count of $270,000 and expense of $26,507.37 in connection with
the issuance of petitioner's 4½ per cent. bonds on March 1, 1928; and
that the Commissioner thereby understand petitioner's taxable net
income, and the taxable net income of the affiliated group, for the
year 1928 by the amount of $75,902.81, which should be restored to
income in the redetermination of the deficiency.

Wherefore, it is prayed that the Board redetermine the correct de-
ficiency for the year 1928, even though the amount thereof be greater
than the deficiency determined by the Commissioner.

(Sgd.) C. M. CHAREST.
General Counsel, Bureau of Internal Revenue.

Of Counsel:
F. R. SHEARER,
Special Attorney, Bureau of Internal Revenue.

32 Before United States Board of Tax Appeals

Docket No. 56720. Promulgated August 24, 1937

PENNSYLVANIA WATER & POWER COMPANY, PETITIONER
v.
COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Opinion

Rendered August 24, 1937

1. Petitioner acquired all the assets of its wholly owned subsidiary
in consideration of the delivery to it of all the subsidiary's capital stock

and the assumption by it of all of the subsidiary's indebtedness. This was done under a Pennsylvania statute sometimes referred to as permitting a "short form of merger." Statute examined and held acquisition by petitioner of the assets of its subsidiary under the statute was a purchase and not a merger.

2. Petitioner retired bonds issued by its former subsidiary and deducted from its gross income, (a) the unamortized discount and expense incurred in the issuance of such bonds and (b) premium paid by it in the retirement of such bonds. Held, following Metropolitan Edison Co., 35 B. T. A. 10, that the premium paid by petitioner is deductible from its gross income but the unamortized discount and expenses are not.

Edwin M. Sturtevant, Esq., for the petitioner.

William E. Davis, Esq., for the respondent.

MELLOTT: The Commissioner disallowed several hundred thousand dollars, claimed by petitioner as deductions from its gross income in its return for the year 1928, and determined a deficiency in income tax against it for said year in the amount of $86,508.25. He concedes that he erred in disallowing $339,900.10 but contends that a deficiency of $39,675.82 exists by reason of the fact that $37,659.52 of the amount deducted by petitioner was improperly deducted and should be included in its taxable income. All of the facts were stipulated. We set out herein the portion of the stipulation especially pertinent to the issues raised.

1. Prior to 1924, petitioner generated all electricity sold by it exclusively by water power at its hydroelectric plant located on the Susquehanna River at Holtwood, Pennsylvania. The amount of electrical energy generated at Petitioner's hydroelectric plant varied from time to time due to changing river conditions. When the flow of the water in the Susquehanna River was high a maximum amount of electrical energy could be generated, and when the water was low, or ice had accumulated at the dam, the output of the plant was materially reduced. In order to supply Petitioner's customers with adequate and continuous service, and utilize the river flow to the best advantage, it became necessary to provide an auxiliary supply of electrical energy generated by steam.

2. Petitioner was advised by its counsel that it had no corporate powers to engage in the business of generating electricity by steam, and that it would be necessary to incorporate a subsidiary to carry on this activity. Accordingly, on August 9, 1924, Holtwood Power Company, hereinafter referred to as the "Holtwood Company," was incorporated under the laws of the Commonwealth of Pennsylvania, with an authorized capital of $1,500,000 consisting of 15,000 shares of the par value of $100 each. All of these shares were purchased by Petitioner, and 50 of the shares were placed in the names of seven directors in order to qualify them as directors, Petitioner, however, remaining the equitable owner of the said 50 shares. With

the funds paid by Petitioner to the Holtwood Company fo
34 the capital stock, and the proceeds received from the sale o
the bonds hereinafter mentioned, Holtwood Company erecte
the auxiliary steam-generating plant on a site immediately adjacen
to Petitioner's hydroelectric plant.

3. By an agreement between Petitioner and the Holtwood Com
pany, dated August 26, 1924, a copy of which is attached hereto a
"Exhibit No. 1," which agreement ran to January 1, 1975, Holtwoo
Company agreed to deliver to Petitioner, on its order, electric powe
up to the full capacity of the steam generating plant, and Pet
tioner agreed to pay, or provide for the payment, monthly of ever
obligation and expense of the Holtwood Company, and a net retur
of 8% annually upon the par value of all its securities at any tim
outstanding. Among the items enumerated in the agreement t
be paid by Petitioner were (1) "a sum to provide for amortizatio
of debt, discount, and security issue expense," and (2) "the expense
attending the issue, registration, and transfer of the capital stoc
and bonds * * * now or hereafter issued and outstanding, an
all interest on its bonded or other indebtedness at any time out
standing or existing, as and when said several interest payment
may become due and payable."

From the date of completion of the Holtwood Company's steam
plant on August 16, 1925, to the date of the consummation of th
"short form of merger," hereinafter mentioned, of the Holtwoo
Company into Petitioner (December 21, 1927), all the electric en
ergy generated at the steam plant was delivered to Petitioner
Petitioner's officers were officers of the Holtwood Company, and th
Holtwood Company, during its entire existence, was managed and
the steam plant operated by Petitioner's officers and employees. The
officers of the Holtwood Company did not receive any salaries from
that Company, and the said Company did not have any employees
Petitioner, however, increased the number of its employees in order
to operate the steam plant. The steam plant of the Holtwood Com
pany was operated only at such times as conditions of river flow
made it necessary for Petitioner to utilize an auxiliary supply of
electric energy. It was operated at all times as a department of
Petitioner.

35 4. For the purpose of providing part of the funds for the con-
struction of the steam power plant, Holtwood Company exe-
cuted a mortgage and deed of trust to the New York Trust Company,
Trustee, dated September 1, 1924, whereby it conveyed all of its prop-
erty to the said trustee for the purpose of securing bonds to be issued
under said deed of trust not in excess of $25,000,000 at any one time
outstanding. A copy of the said deed of trust is filed herewith, marked
"Exhibit No. 2." The deed of trust (page 15) provided that the bonds
might be issued in one or more series; that a series of bonds limited to
$2,750,000 in aggregate principal amount should be designated "Series
A" (page 16); that Series A bonds should be dated September 1, 1924

(page 17), should bear interest at the rate of six per centum (6%) per annum (page 16), should mature September 1, 1954 (page 16), and should be redeemable at the option of the Holtwood Company, as a whole or in any part, on any interest date prior to maturity at the principal amount thereof, together with a premium of seven per centum (7%) of the principal amount thereof in the case of bonds redeemed on or before September 1, 1929 (page 17), which premium was to be reduced one-fourth of one per cent. on March 1, 1930 and on the first day of March in each year thereafter until March 1, 1953, when the redemption price would be 101 per cent. (page 17).

5. Subsequent to the execution of the said deed of trust, the Holtwood Company sold to the public $2,750,000 par value of its Series A 6% First Mortgage Sinking Fund Gold Bonds, dated September 1, 1924, maturing September 1, 1954, and received therefor a cash consideration of $2,612,500.

6. The issuance of the Holtwood Bonds comprehended a financing cost of $162,749.87 represented by discount and expenses as follows:

Discount	$137,500.00
Expenses	25,249.87
Total	$162,749.87

36 7. This amount of $162,749.87 was set up on the books of the Holtwood Company as "Unamortized Bond Discount and Expense." Each year from 1924 to 1927, inclusive, the discount and expense was amortized on the books of the Holtwood Company by charging off an aliquot portion of the said discount and expense based on the life of the bonds.

8. The Holtwood Company had no income other than payments made to it by Petitioner pursuant to the agreement dated August 26, 1924, above referred to and filed herewith as "Exhibit No. 1."

9. Each year from 1924 to 1927, inclusive, a consolidated income tax return was filed for Petitioner and the Holtwood Company. In the said income tax returns the discount and expense, applicable to the Holtwood Bonds, was pro-rated or amortized by taking as deductions in each of said years an aliquot portion of the said discount and expense based on the life of the bonds.

The Petitioner was required by the agreement of August 26, 1924, to make payments to the Holtwood Company on account of the amortization of bond discount and expense, which payments were deductible from Petitioner's gross income as ordinary and necessary business expenses (cost of power), and the Holtwood Company reported these payments as income, which were offset by its deductions on account of amortization of discount and expense. The said agreement ran to January 1, 1975 and the Holtwood Bonds matured September 1, 1954.

10. After the incorporation of the Holtwood Company, Petitioner was advised by its counsel that Petitioner and the Holtwood Company could not consolidate or merge because they were not engaged

in similar businesses, since Petitioner had power to supply water
the public, which power the Holtwood Company did not possess. O
June 26, 1926, the Supreme Court of Pennsylvania, in the case of Yo
Haven Water and Power Co. et al. v. Public Service Commission
Pennsylvania et al., 287 Pa. 241, 134 Atl. 419, decided, und
37 similar facts, that such companies might consolidate or mar
provided the power to supply water be legally discarded. O
October 4, 1927, pursuant to the holding of the Court in that ca
Petitioner surrendered its corporate power to store, transport, a
supply water in accordance with the procedure prescribed by the co
poration law of Pennsylvania.

Thereafter a "short form of merger" of the Holtwood Compa
into Petitioner was effected under Section 23 of the Act of the Commo
wealth of Pennsylvania of April 29, 1874, as amended by Section 5
the Act of April 17, 1876, and the Act of June 2, 1915, a copy of whi
is filed herewith as "Exhibit No. 3." Pursuant to and in accordan
with the procedure prescribed by the said Act, as amended, Holtwo
Company, by deed dated December 21, 1927, transferred all its fra
chises and property, real, personal and mixed to Petitioner, the so
consideration for the transfer being the delivery to the Holtwo
Company of all its capital stock, and Petitioner assuming the indebte
ness of the Holtwood Company. Thereupon, pursuant to the pr
visions of the Act of 1874, as amended, Holtwood Company, b
operation of law ceased to exist. All the returns and certificat
relating to the said "short form of merger," required by the said A
to be filed, were duly filed in the Office of the Secretary of t
Commonwealth.

11. In determining the income tax liability of Petitioner and t
Holtwood Company for the year 1927, during which year the "sho
form of merger" of the Holtwood Company into Petitioner was co
summated, the said companies and the Respondent treated the sa
merger as a non-taxable transaction giving rise to no gain or loss.

12. On March 1, 1928, Petitioner sold to the public $6,000,000 p
value of its Series B 4½% Bonds, dated March 1, 1928, maturi
March 1, 1968.

13. The purpose of the issue of $6,000,000 par value of Petitioner
Series B 4½% Bonds was to apply the proceeds to the retirement
$3,000,000 of Petitioner's Series A 5½% Bonds and $2,750,000 p
value of Holtwood Bonds.

38 14. On March 1, 1928, pursuant to notice dated January 2
1928 (given by Petitioner as successor to the Holtwood Com
pany) duly published and mailed to holders of the Holtwood Bond
Petitioner retired for cash the $2,750,000 of Holtwood Bonds, payi
therefor par plus a premium of 7%, or $192,500. None of the Hol
wood Bonds were exchanged for Petitioner's Series B Bonds.

In retiring the Holtwood Bonds, Petitioner exercised the optio
originally reserved to the Holtwood Company in the deed of tru

under which the bonds were issued, to which Petitioner succeeded as a result of the "short form of merger."

15. On January 1, 1928, the year of the retirement of the Holtwood Bonds, the balance of discount and expense applicable to said bonds, which had not been amortized and deducted for income tax purposes, amounted to $145,159.52.

16. In its income tax returns for 1928 Petitioner claimed (among others) the following deductions:

Amortized portion of discount and expense applicable to Holtwood Bonds for the period January 1, 1928 to February 28, 1928	$904.42
Unamortized discount and expense on Holtwood Bonds	144,255.10
Premium paid in retirement of Holtwood Bonds	192,500.00
Total	337,659.52

The question, as stated by both parties upon brief, is—"Is petitioner entitled, as the successor of its wholly owned subsidiary, Holtwood Power Company, to deduct from gross income for the year 1928, (a) the unamortized discount and expense incurred in the issuance, and, (b) premium paid in the retirement of Holtwood Power Company Series A 6% First Mortgage Sinking Fund Gold bonds, dated September 1, 1924, and maturing September 1, 1954, which petitioner re-39 tired for cash on March 1, 1928, at par plus premium of 7% by the use of part of the proceeds of Petitioner's Series B 4½% bonds?" The portion of the question re...red to as (a) will be considered first.

Petitioner contends, and it is apparently conceded by respondent, that if the transaction by which the petitioner assumed the bonds of Holtwood Power Company constituted a merger or consolidation, then petitioner is entitled to deduct the unamortized discount and expense of issuing such bonds, which the parties have stipulated to be $144,255.10. This contention is sound and accords with the view frequently expressed by the courts and this Board. Western Maryland Railway Co. v. Commissioner, 33 Fed. (2d) 695; New York Central Railroad Co. v. Commissioner, 79 Fed. (2d) 247; Illinois Power & Light Corporation, 33 B. T. A. 1189; Metropolitan Edison Co., 35 B. T. A. 1110; Coast Counties Gas & Electric Co., 36 B. T. A.—(July 27, 1937). But if the transaction is a mere purchase or sale, the purchasing corporation is not entitled to the deduction. Turner-Farber-Love Co. v. Helvering, 68 Fed. (2d) 416; American Gas & Electric Co. v. Commissioner, 85 Fed. (2d) 527, affirming 33 B. T. A. 471; American Gas & Electric Co. v. United States, 17 Fed. Supp. 151; Metropolitan Edison Co., supra. (Issue IV.) It is therefore necessary to determine whether the transaction was a sale, as contended by the respondent, or a merger, as contended by the petitioner.

The instant proceeding is not distinguishable upon its facts from those in Metropolitan Edison Co., supra, bearing upon issue V. There, as here, there was a so-called "short form merger" under the

identical section of the Pennsylvania law now under consideration. The section reads as follows:

"Any corporation created under the provisions of this act
40 * * * may reduce its capital stock * * * by a vote of
the stockholders * * *; and it shall be lawful for any corporation in the same manner to sell, assign, dispose of, and convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal, and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid * * *."

We said, in passing upon the issue in that case, that the "so-called merger * * * amounted in effect to a sale by the subsidiary of its assets to the parent corporation." We have reexamined the question in the light of the authorities cited by petitioner in its able brief but are not persuaded that we were wrong in the Metropolitan Edison case or that a different conclusion should be reached under the stipulated facts in this case. However, in view of the fact that our decision in the Metropolitan Edison case was promulgated subsequent to the filing of the briefs in the instant case, it will not be amiss to discuss some of the cases cited by petitioner.

Petitioner contends that the "short form merger" meets all the essential legal requirements of a merger, as defined by the Circuit Court of Appeals for the Second Circuit in Cortland Specialty Co. v. Commissioner, 60 Fed. (2d) 937, certiorari denied, 288 U. S. 599, including the requirement added in American Gas & Electric Co., supra. It relies especially upon the portion of the opinion in the Cortland Specialty case in which the court says that "A merger ordinarily is an absorption by one corporation of the properties and franchises of another whose stock it has acquired. The merged corporation ceases to exist and the merging corporations alone survive." While the definition was never intended to embrace all
situations which might arise, the court advisedly using the
41 word "ordinarily" and referring later in its opinion to the fact that the statutes of the states vary "in respect to how far the constituent companies may be deemed to survive the creation of the new or modified corporate structure," we are nevertheless constrained to hold that petitioner has not shown itself to be within that definition.

Petitioner contends that the opinion of the Supreme Court of Pennsylvania in Merwine v. Mt. Pocono Light & Improvement Co., 304 Pa. 517; 156 Atl. 150, "is a definite holding that a transfer by a corporation, under the procedure prescribed by the Act of 1876, as amended (shown supra), of its franchises and property to a corporation with which it is affiliated, under circumstances similar to those of the case at bar, is merely a formality and the transaction in reality is a merger of the two companies." While the court did say—though perhaps it was obiter dictum in view of the fact that it was not re-

quired to make any such determination—"that the transaction between the two corporations was in reality a merger," in the very next sentence it referred to the transferee corporation as "a purchaser cum onere" and instructed the personal injury plaintiff, in the event of judgment against the transferor corporation, "to levy where defendant's [transferor corporation] assets liable for the judgment may be found." It also held specifically that the transferor corporation had not "ceased to exist"—an essential under the definition petitioner is relying upon—saying:

"The statute of 1874 and its amendments plainly reveal that the words "shall cease to exist" primarily refer to a cessation of carrying on the business for which the selling corporation was created. * * * Defendant corporation [selling corporation] not having been legally dissolved, its present condition is rather that of an inactive cor-
42 poration and it is not altogether dead. Before a corporation has ceased to exist in the absolute sense here contended for, it must fully and definitely close its affairs, and the fact that a corporation has 'ceased to do business' does not preclude it from exercising its various rights to accomplish this purpose * * *.

The above holding accords with the views of the same court as expressed in Commonwealth v. Lumber City Water Co., 225 Pa. 317; 74 Atl. 238.

Petitioner also relies upon York Haven Water & Power Co. v. Public Service Commission of Pennsylvania, 287 Pa. 241; 134 Atl. 419. That case involved the question of the right of an electric light, heat, and power company to purchase or merge with a hydroelectric or water power company. The court in its opinion said:

"There are two forms of consolidation in Pennsylvania, a short and a long form merger. These are accomplished by the act of 1876, as amended, and the act of 1909. The act of April 17, 1876 (P. L. 33 [30]), as amended, provides that such sale may take place if the 'franchises are not inconsistent' with this act. And the Merger Act 1909 (P. L. 408; Pa. St. 1920, § 5748 et seq.) permits consolidation between corporations 'transacting the same or similar lines of business.'"

In a later decision, In re Buist's Estate, 297 Pa. 537; 147 Atl. 606, the court, considering and discussing whether the merger of a number of banking institutions into the Philadelphia National Bank under the act of Congress (November 7, 1918, ch. 209, § 1, 40 Stat. 1043, U. S. C. A., title 12, § 33) empowering national banks to consolidate, constituted a sale, liquidation, or a merger or consolidation of assets, stated as follows:

"* * * Care should be taken to distinguish consolidation from proceedings under the Act of April 17, 1876, P. L. 33 [30] § 5,
43 as amended (Pa. St. 1920, § 5694), often referred to as a 'short form merger' (See York Haven W. & P. Co. v. P. S. C., 287 Pa. 241, 134 A. 419); its operation in reality effects a sale of all the company's assets."

The new conception was not on the basis of sale, but of a merger or consolidation of assets, which is opposed to sale.

In a number of cases the Pennsylvania courts have referred to transactions under the act in question as being sales. See Koehler v. St. Mary's Brewing Co., 228 Pa. 628; 77 Atl. 1016; Greensburg Borough v. Westmoreland Water Co., 240 Pa. 481; 87 Atl. 995; Ringler v. Atlas Portland Cement Co., 301 Pa. 176; 151 Atl. 815. Thus in the last case cited, supra, the court refers to the act as regulating "the sale of franchises and assets of one Pennsylvania corporation to another, involving the dissolution of the selling corporation," while in a very recent case, In re Daily's Estate, 186 Atl. 754 (1936), the court, citing with approval the Buist Estate case, supra, holds that "a merger is not a sale or liquidation of corporate property but a consolidation of property, powers, and facilities."

It will be noted that the act authorizes a corporation "to sell, assign, dispose of and convey" its property. The stipulation shows that that is what occurred here. Holtwood, by deed, transferred all its franchises and property to petitioner, the sole consideration being the delivery to it of its capital stock and the assumption of its indebtedness. "The transaction certainly bore all the characteristics of a simple sale" (Cortland Specialty Co. v. Commissioner, supra), and we are still of the opinion, which we expressed in Metropolitan Edison Co., supra, that the so-called "short form merger" was, in effect, simply a sale by Holtwood of its assets to this petitioner. It follows that the respondent did not err in disallowing, as a deduction from petitioner's gross income, the unamortized discount and expense on the Holtwood bonds in the amount of $144,255.10.

44 Petitioner must prevail in so far as subdivision (b) of the question is concerned, though not upon the grounds urged in its brief. It is now settled that premiums paid by a parent corporation in the retirement of bonds issued by its subsidiary and assumed by it in a transfer of the assets of the subsidiary to it, are deductible from the gross income of the parent corporation, though a contrary view at one time prevailed. The question was recently considered by this Board in Metropolitan Edison Co., supra (issue III). Therein we reviewed the court and Board decisions and concluded that the reasoning under which a conclusion had been reached that such expenditures were not deductible was unsound and should no longer be followed. We pointed out that, while we thought they were deductible as ordinary and necessary expenses of carrying on a trade or business (section 23 (a), Revenue Act of 1928), if they were not properly so classified they were nevertheless deductible as losses (section 23 (e), Revenue Act of 1928). Such was the holding of the Court of Claims in American Gas & Electric Co. v. United States, 17 Fed. Supp. 151, which we thought and still think to be sound. The portion of our opinion in Coast Counties Gas & Electric Co., 33 B. T. A. 1119, holding that such premiums were not deductible, has now been set aside. Coast Counties Gas & Electric Co., 36 B. T. A. (July 27, 1937). The facts before

as in the instant proceeding clearly require that we reach, and we do reach, the same conclusion here.

It is therefore held that the respondent erred in disallowing the deduction from petitioner's gross income of the premium paid by it in retirement of the Holtwood Power Co. bonds, amounting to $192,500.

Deficiency shall be recomputed in accordance with the views herein expressed.

Judgment will be entered under Rule 50.

45 **Before United States Board of Tax Appeals**

Decision

Entered October 16, 1937

Pursuant to the Board's Opinion, promulgated August 24, 1937, the respondent herein having on October 4, 1937, filed a motion and recomputation of tax, and the petitioner herein having on October 9, 1937, filed an acquiescence in said recomputation, now, therefore, it is

Ordered and decided that there is a deficiency in income tax of $16,575.82 for the year 1928.

[SEAL] (Sgd.) EUGENE BLACK.
Member, U. S. Board of Tax Appeals.

In United States Circuit Court of Appeals

Petition for review

Filed December 22, 1937

To the Honorable, the Judges of the United States Circuit Court of Appeals for the Third Circuit:

Your petitioner, Pennsylvania Water & Power Company, respectfully shows:

I. Jurisdiction for review

This is a proceeding for review by the United States Circuit Court of Appeals for the Third Circuit, pursuant to Sections 1001, 1002, and 1003 of the Revenue Act of 1926, as amended, of a decision of the United States Board of Tax Appeals, entered on the sixteenth day of October, 1937, and redetermining a deficiency in income taxes for the calendar year 1928 against your petitioner, in the amount of $16,575.82.

Your petitioner is a corporation organized under the laws of the State of Pennsylvania, having its corporate office at Holtwood, Pennsylvania.

46 For the calendar year 1928, petitioner made its income tax return to the Collector of Internal Revenue for the First District of Pennsylvania, whose office is located in the City of Philadelphia, State of Pennsylvania.

II. Nature of controversy

Petitioner operates a hydroelectric power plant located on the Susquehanna River at Holtwood, Pennsylvania. It owned all of the capital stock of Holtwood Power Company, which it organized for the purpose of constructing a steam power plant to be operated as an auxiliary to the hydro plant. Under a contract between the two companies, petitioner operated the steam plant with its own employees, received the entire output of the electric energy generated at the plant and was obligated to pay annually to the Holtwood Company an amount to cover all expenses, taxes, bond interest, bond discount, etc.

For the purpose of financing the building of the steam power plant the Holtwood Power Company sold to the public its Thirty-Year First Mortgage Bonds dated September 1, 1924. The bonds were sold at 95 and the discount of five points plus the expense incident to the issue amounted to $162,749.87. Both the Courts and the Commissioner of Internal Revenue consider such discount and expense to be in the nature of additional deferred interest on the bonds to be amortized over their life. If the bonds run for thirty years, as in this case, one-thirtieth of the discount and expense is deductible from gross income each year in arriving at taxable net income. If the bonds are retired before maturity by the issuing corporation, or by a corporation into which it is merged or with which it is consolidated, the unamortized discount and expense is deductible in its entirety for the year in which the bonds are retired.

47 On December 21, 1927, pursuant to the provisions of Section 23 of the Act of the Commonwealth of Pennsylvania of April 29, 1874, as amended by Section 5 of the Act of April 17, 1876, and the Act of June 2, 1915, the Holtwood Power Company transferred all its property as an entirety to petitioner and by operation of law ceased to exist.

On March 1, 1928, petitioner retired for cash the outstanding Holtwood Power Company bonds at par plus a premium of 7 per cent. In its income tax return for said year, petitioner claimed as deductions (1) the unamortized discount and expense on the bonds and (2) the 7 per cent. premium paid in connection with their retirement. The two deductions were disallowed by the Commissioner of Internal Revenue.

It was stipulated before the Board of Tax Appeals that if the Commissioner erred in disallowing the said two deductions, judgment should be entered for the petitioner in the amount of $843.32. The Board affirmed the action of the Commissioner of Internal Revenue in disallowing the deduction of unamortized discount and expense, but reversed the action of the Commissioner with respect to the premium and allowed it as a deduction.

The sole question here is whether the action of the Board of Tax Appeals in affirming the disallowance by the Commissioner of Internal Revenue of the deduction of the unamortized bond discount

and expense on the Holtwood Power Company bonds was proper under the law and the evidence.

Petitioner claims that the transfer to it of the property of the Holtwood Power Company, effected pursuant to the aforementioned statute, was a "merger" and also that the transaction involved only a change in the corporate form and not a change in substance. The Commissioner of Internal Revenue contended, and the Board
48 of Tax Appeals decided, that the transaction was a "sale," and, therefore, petitioner was not entitled to deduct the unamortized discount and expense.

III. Assignments of error

Your petitioner further shows that it is aggrieved by the action of said Board and injured thereby and that the errors complained of are as follows:

1. Said Board erred in basing its decision on the ground that the transaction effected on December 21, 1927, by petitioner and Holtwood Power Company, pursuant to the Act of the Commonwealth of Pennsylvania of April 29, 1874, as amended, was a sale of assets.

2. Said Board erred in the failure to find that the said transaction effected pursuant to the Act of the Commonwealth of Pennsylvania of April 29, 1874, as amended, was a "merger," or, in the alternative, that it was a corporate change in form only and not a change in substance.

3. Said Board erred in holding that petitioner was not entitled to deduct from its gross income for the year 1928 the amount of unamortized bond discount and expense applicable to the said Holtwood bonds.

4. Said Board erred in rendering judgment for the Commissioner of Internal Revenue in the amount of $16,575.82, whereas judgment should have been entered for the petitioner in the amount of $843.32.

Wherefore, your petitioner prays that this Court may review the decision of the United States Board of Tax Appeals in this cause, reverse the same and direct the said Board to allow as a deduction from petitioner's gross income for the year 1928 the amount of
49 unamortized bond discount and expense applicable to the Holtwood bonds, and enter judgment for the petitioner in the amount of $843.32; and that this Court may grant such other and further relief as may appear proper in the premises.

PENNSYLVANIA WATER & POWER COMPANY.
By J. A. WALLS, *President.*
CLYDE T. WARREN,
EDWIN M. STURTEVANT,
Attorneys for Petitioner.
1707 Lexington Building, Baltimore, Maryland.
[*Duly sworn to by J. A. Walls; jurat omitted in printing.*]

50 Before United States Board of Tax Appeals

Statement of evidence

Filed December 30, 1937

The above cause came on for hearing before the Honorable Arthur J. Mellott, Member of the United States Board of Tax Appeals, on the thirtieth day of November, 1936, there being present the petitioner and respondent by their respective counsel.

Thereupon, the cause was submitted upon stipulation of facts, together with certain exhibits. The substance of the stipulation, material and necessary to the determination of the assignments of error set out by petitioner in its petition for review by the United States Circuit Court of Appeals for the Third Circuit of the decision of the Board of Tax Appeals, is as follows:

Preliminary facts

1. Petitioner, Pennsylvania Water & Power Company, is a corporation duly organized and existing under the laws of the Commonwealth of Pennsylvania. Petitioner was incorporated on January 13, 1910, and at all times since its incorporation has maintained its principal office and place of business at Holtwood, Pennsylvania.

2. Petitioner owns and operates a hydroelectric plant located on the Susquehanna River at Holtwood, Pennsylvania, and a steam electric plant adjacent thereto.

3. Within the time specified by law, to wit, on March 12, 1929, petitioner, on behalf of itself and subsidiary corporations which were affiliated with it within the meaning of Section 142 of the Revenue Act of 1928, duly filed with the Collector of Internal Revenue at Philadelphia, Pennsylvania, a consolidated income tax return
51 (on form No. 1120) embracing the income and deductions of the said corporations for the calendar year 1928, disclosing an income tax liability of $174,805.88, and paid the said tax in four installments.

4. The books of petitioner at all times since its incorporation have been kept upon the accrual basis of accounting. All its Federal income tax returns have been filed in accordance with said basis for calendar years. The parties hereby stipulate and agree that said basis of accounting is proper.

5. On February 18, 1931, respondent sent to petitioner by registered mail a notice of deficiency in income tax for the calendar year 1928. A copy of said notice of deficiency, marked "Exhibit A," was filed with the petition herein and is hereby by reference incorporated herein.

Stipulation of facts in reference to Holtwood bonds

1. Prior to 1924 petitioner generated all electricity sold by it exclusively by water power at its hydroelectric plant located on

the Susquehanna River at Holtwood, Pennsylvania. The amount of electrical energy generated at petitioner's hydroelectric plant varied from time to time due to changing river conditions. When the flow of the water in the Susquehanna River was high a maximum amount of electrical energy could be generated, and when the water was low, or ice had accumulated at the dam, the output of the plant was materially reduced. In order to supply petitioner's customers with adequate and continuous service, and utilize the river flow to the best advantage, it became necessary to provide an auxiliary supply of electrical energy generated by steam.

2. Petitioner was advised by its counsel that it had no
52 corporate powers to engage in the business of generating electricity by steam, and that it would be necessary to incorporate a subsidiary to carry on this activity. Accordingly, on August 9, 1924, Holtwood Power Company, hereinafter referred to as the "Holtwood Company," was incorporated under the laws of the Commonwealth of Pennsylvania, with an authorized capital of $1,500,000 consisting of 15,000 shares of the par value of $100 each. All of these shares were purchased by petitioner, and 50 of the shares were placed in the names of seven directors in order to qualify them as directors, petitioner, however, remaining the equitable owner of the said 50 shares. With the funds paid by petitioner to the Holtwood Company for the capital stock, and the proceeds received from the sale of the bonds hereinafter mentioned, Holtwood Company erected the auxiliary steam generating plant on a site immediately adjacent to petitioner's hydroelectric plant.

3. By an agreement between petitioner and the Holtwood Company, dated August 26, 1924, a copy of which is attached hereto as "Exhibit No. 1," which agreement ran to January 1, 1975, Holtwood Company agreed to deliver to petitioner, on its order, electric power up to the full capacity of the steam generating plant, and petitioner agreed to pay, or provide for the payment, monthly of every obligation and expense of the Holtwood Company, and a net return of 8 per cent. annually upon the par value of all its securities at any time outstanding. Among the items enumerated in the agreement to be paid by petitioner were (1) "a sum to provide for amortization of debt, discount, and security issue expense," and (2) "the expenses attending the issue, registration, and transfer of the capital stock and bonds * * * now or hereafter issued and
53 outstanding, and all interest on its bonded or other indebtedness at any time outstanding or existing, as and when said several interest payments may become due and payable."

From the date of completion of the Holtwood Company's steam plant on August 16, 1925, to the date of the consummation of the "short form of merger," hereinafter mentioned, of the Holtwood Company into petitioner (December 21, 1927), all the electric energy generated at the steam plant was delivered to petitioner. Petitioner's officers were officers of the Holtwood Company, and the Holtwood Company, during its entire existence, was managed and the steam

plant operated by petitioner's officers and employees. The officers of the Holtwood Company did not receive any salaries from that Company and the said Company did not have any employees. Petitioner, however, increased the number of its employees in order to operate the steam plant. The steam plant of the Holtwood Company was operated only at such times as conditions of river flow made it necessary for petitioner to utilize an auxiliary supply of electric energy. It was operated at all times as a department of petitioner.

4. For the purpose of providing part of the funds for the construction of the steam power plant, Holtwood Company executed a mortgage and deed of trust to the New York Trust Company, Trustee, dated September 1, 1924, whereby it conveyed all its property to the said trustee for the purpose of securing bonds to be issued under said deed of trust not in excess of $25,000,000 at any one time outstanding. The deed of trust (page 15) provided that the bonds might be issued in one or more series; that a series of bonds limited to $2,750,000 in aggregate principal amount should be designated "Series A" (page 16); that Series A bonds should be dated September 1, 1924 (page 17), should bear interest at the rate of six per centum
54 (6%) per annum (page 16), should mature September 1, 1954 (page 16), and should be redeemable at the option of the Holtwood Company, as a whole or in any part, on any interest date prior to maturity at the principal amount thereof, together with a premium of seven per centum (7%) of the principal amount thereof in the case of bonds redeemed on or before September 1, 1929 (page 17), which premium was to be reduced one-fourth of one per cent. on March 1, 1930, and on the first day of March in each year thereafter until March 1, 1953, when the redemption price would be 101 per cent. (page 17).

5. Subsequent to the execution of the said deed of trust, the Holtwood Company *Company* sold to the public $2,750,000 par value of its Series A 6 Per Cent. First Mortgage Sinking Fund Gold Bonds, dated September 1, 1924, maturing September 1, 1954, and received therefor a cash consideration of $2,612,500.

6. The issuance of the Holtwood Bonds comprehended a financing cost of $162,749.87 represented by discount and expenses as follows:

Discount	$137,500.00
Expenses	25,249.87
Total	$162,749.87

7. This amount of $162,749.87 was set up on the books of the Holtwood Company as "Unamortized Bond Discount and Expense." Each year from 1924 to 1927, inclusive, the discount and expense was amortized on the books of the Holtwood Company by charging off an aliquot portion of the said discount and expense based on the life of the bonds.

8. The Holtwood Company had no income other than payments made to it by petitioner pursuant to the agreement dated August 26, 1924, above referred to and filed herewith as "Exhibit No. 1."
55 9. Each year from 1924 to 1927, inclusive, a consolidated income tax return was filed for petitioner and the Holtwood

Company. In the said income tax returns the discount and expense, applicable to the Holtwood Bonds, was pro-rated or amortized by taking as deductions in each of said years an aliquot portion of the said discount and expense based on the life of the bonds.

The petitioner was required by the agreement of August 26, 1924, to make payments to the Holtwood Company on account of the amortization of bond discount and expense, which payments were deductible from petitioner's gross income as ordinary and necessary business expenses (cost of power), and the Holtwood Company reported these payments as income, which were offset by its deductions on account of amortization of discount and expense. The said agreement ran to January 1, 1975 and the Holtwood Bonds matured September 1, 1964.

10. After the incorporation of the Holtwood Company, petitioner was advised by its counsel that petitioner and the Holtwood Company could not consolidate or merge because they were not engaged in similar businesses, since petitioner had power to supply water to the public, which power the Holtwood Company did not possess. On June 26, 1926, the Supreme Court of Pennsylvania, in the case of York Haven Water and Power Co. et al. v. Public Service Commission of Pennsylvania et al., 287 Pa. 241, 134 Atl. 419, decided, under similar facts, that such companies might consolidate or merge provided the power to supply water be legally discarded. On October 4, 1927, pursuant to the holding of the Court in that case, petitioner surrendered its corporate power to store, transport and supply water in accordance with the procedure prescribed by the corporation law of Pennsylvania.

Thereafter a "short form of merger" of the Holtwood Company into petitioner was effected under Section 23 of the Act of the Commonwealth of Pennsylvania of April 29, 1874, as amended by Section 5 of the Act of April 17, 1876, and the Act of June 2, 1915, a copy of which is filed herewith as "Exhibit No. 3." Pursuant to and in accordance with the procedure prescribed by the said Act, as amended, Holtwood Company, by deed dated December 21, 1927, transferred all its franchises and property, real, personal, and mixed to petitioner, the sole consideration for the transfer being the delivery to the Holtwood Company of all its capital stock, and petitioner assuming the indebtedness of the Holtwood Company. Thereupon, pursuant to the provisions of the Act of 1874, as amended, Holtwood Company, by operation of law, ceased to exist. All the returns and certificates relating to the said "short form of merger," required by the said Act to be filed, were duly filed in the Office of the Secretary of the Commonwealth.

11. In determining the income tax liability of petitioner and the Holtwood Company for the year 1927, during which year the "short form of merger" of the Holtwood Company into petitioner was consummated, the said companies and the respondent treated the said merger as a non-taxable transaction giving rise to no gain or loss.

12. On March 1, 1928, pursuant to notice dated January 27, 1928 (given by petitioner as successor to the Holtwood Company), duly published and mailed to holders of the Holtwood Bonds, petitioner retired for cash the $2,750,000 of Holtwood Bonds, paying therefor par plus a premium of 7 per cent., or $192,500.

57 In retiring the Holtwood Bonds, petitioner exercised the option, originally reserved to the Holtwood Company in the deed of trust under which the bonds were issued, to which petitioner succeeded as a result of the "short form of merger."

13. On January 1, 1928, the year of the retirement of the Holtwood Bonds, the balance of discount and expense applicable to said bonds, which had not been amortized and deducted for income tax purposes, amounted to $145,159.52.

14. In its income tax return for 1928 petitioner claimed (among others) the following deductions:

Amortized portion of discount and expense applicable to Holtwood Bonds for the period January 1, 1928 to February 28, 1928	$904.43
Unamortized discount and expense on Holtwood Bonds	144,255.10
Premium paid in retirement of Holtwood Bonds	192,500.00
Total	$337,659.53

15. The "Uniform Classification of Accounts for Electric Companies," prescribed by the Public Service Commission of Pennsylvania, which has been in force since January 1, 1919, contains the following provisions with reference to unamortized debt discount and expense:

"BALANCE SHEET ACCOUNTS

"UNAMORTIZED DEBT DISCOUNT AND EXPENSE

"Charge to this account all discounts and necessary expenses incurred in the issue by the utility of bonds and other evidences of indebtedness which mature more than one year from the date of their issue.

58 "By discount is meant the excess of the par value of such evidences of indebtedness, plus the interest accrued thereon at the time of their issue, over the actual cash value of the consideration received for them.

"Necessary expenses incurred in the issue of such evidences of indebtedness shall include fees for drafting mortgages and trust deeds, fees and taxes for recording mortgages and trust deeds, fees to trustees provided in mortgages and trust deeds, fees to underwriters and brokers for marketing such evidences of indebtedness, and other expenses of like character; the cost of engraving and printing bonds, certificates of indebtedness, and other commercial paper.

"*Discount on bonds and other evidences of indebtedness issued by others, and later assumed by the utility, shall be included in this account.* [Italics added.]

"At or before the close of each fiscal period, credit to this account and charge to '708. Amortization of Debt Discount and Expense' account, or to '296. Interest During Construction' account as provided

therein, a proportion of such discount and expense based upon the life of such evidences of indebtedness to date of maturity. Such discount and expense may, if desired, be amortized more rapidly through charges of all or any part of it, either at the time of issue or later, to '811. Other Deductions from Surplus' account."

"GROSS INCOME DEDUCTION ACCOUNTS

"AMORTIZATION DEDUCTIONS

"Amortization of Debt Discount and Expense—

"Charge, at or before the close of each fiscal period, to this account and credit to '130. Unamortized Debt Discount and Expense' account that proportion of the unextinguished discount and expense of the utility which is applicable thereto.

"The charge for each fiscal period shall be such an amount that it will, through regular application during the period from the date of the sale to the date of maturity of the evidences of indebtedness upon which the discount and expense was incurred, completely extinguish such discount and expense.

"The utility may amortize its debt discount and expense sooner by charging all or part of it, either at the time of the issue of the debt to which it applies or later, to '811. Other Deductions from Surplus' account.

"The records supporting the entries to this account shall be so kept that the utility can furnish information as to the amount of debt discount and expense charged to this account during each fiscal period for each class of its funded debt, the date of issue and maturity of the debt to which such discount applies, and the method whereby charges to this account are determined."

16. The following exhibits are filed herewith and constitute part of this stipulation:

No. 1.—Agreement between petitioner and the Holtwood Company dated August 26, 1924.

No. 3.—Copy of applicable sections of the Act of the Commonwealth of Pennsylvania of April 29, 1874, as amended by Section 5 of the Act of April 17, 1876, and the Act of June 2, 1915, under which the "short form of merger" was consummated.

No. 4.—Copy of the "Long Form Merger Act of 1909."

All statements and facts in Exhibit No. 1, attached hereto, shall be taken as true and correct, and such exhibit shall be given the same legal effect as though copied at length into this stipulation. Exhibits Nos. 3 and 4 are attached hereto for convenience only.

17. If the respondent erred in refusing to allow as deductions from gross income of the petitioner for the year 1928 the total amounts disallowed by him, as set forth in paragraph 14 hereof, there is an overpayment of petitioner's income tax for the year 1928 in the amount of $843.32.

The petitioner, Pennsylvania Water & Power Company, tenders and presents the foregoing as a statement of the evidence in this case and

prays that the same be approved by the United States Board of T
Appeals and made a part of the record in this cause.

CLYDE T. WARREN,
EDWIN M. STURTEVANT,
Attorneys for Petitioner.
1707 Lexington Bldg., Baltimore, Maryland.

Exhibit No. 1 to stipulation

This agreement, made this twenty-sixth day of August, A. D. 192 by and between Pennsylvania Water and Power Company, a corpor tion of the Commonwealth of Pennsylvania, hereinafter called "Powe Company" and Holtwood Power Company, a corporation of the Com monwealth of Pennsylvania, hereinafter called "Steam Company, witnesseth:

Whereas, the Steam Company has been organized for the purpose o producing and supplying steam generated electric energy.

And whereas, the Power Company is engaged in the generation and transmission of hydro-electric power derived from the water power o the Susquehanna River and has heretofore entered into contracts to deliver and sell electric power to certain public service companies.

61 And whereas, emergencies and shortages of power may occur whereby it will be difficult or impossible for the Power Company to supply sufficient power from its hydro-electric development to meet its contract requirements.

And whereas, the Power Company desires to protect itself, its customers and consumers who are dependent upon said customers against such emergencies and shortages, and as an incident of its business, cause to be provided for its customers power to supplement that derived from its hydro-electric development.

And now, in consideration of the premises, and of the mutual agreements hereinafter contained, it is agreed:

1. The Steam Company agrees to purchase and the Power Company agrees to sell and convey by such deeds of conveyance as the Steam Company or its counsel learned in the law shall advise, in fee simple, clear of all encumbrances, the following described tract of land:

(Here follows a description of the tract of land to be conveyed.)

The consideration or purchase price for said tract of land, rights and privileges shall be five thousand shares of the common capital stock of Holtwood Power Company, of the par value of Five Hundred Thousand Dollars ($500,000.00) which the Steam Company agrees to issue to the Power Company, upon delivery of a deed of conveyance for the property aforesaid, duly executed and acknowledged.

The Steam Company covenants and agrees that it will erect upon the premises aforesaid a steam power plant of such size and
62 capacity as may be approved by the Power Company, all to the end that the customers of the Power Company and the

consumers of the electrical energy supplied to said customers may be protected against the emergencies and shortages of power aforesaid and may obtain electric current necessary for their requirements.

2. The Steam Company agrees that (subject to its obligations as a public utility) it will deliver, on the order of the Power Company, electric power up to the full capacity of the Steam Company's plant.

3. The Power Company shall pay to Steam Company as compensation hereunder a sum sufficient to provide Steam Company the following:

(a) All costs of management, operation, and maintenance.

(b) An allowance for setting up depreciation, obsolescence, and renewal and replacement reserves or any of them in accordance with the standards accepted by the Pennsylvania Public Service Commission and agreed to by the parties hereto.

(c) A sum to provide for amortization of debt, discount, and security issue expense.

(d) A sum sufficient to provide a net return of eight per cent. annually upon the par value of its securities including its paid up stock.

(e) Payments to be made by Power Company under Section a, Paragraph 3 above, shall include any and all sums necessary for the purpose of defraying the expenses of maintaining the corporate organization of the Steam Company; the expenses attending the issuing, registration, and transfer of the capital stock and bonds of the Steam Company, now or hereafter issued and out-
63 standing, and all interest on its bonded or other indebtedness at any time outstanding or existing, as and when said several interest payments may become due and payable; sinking fund requirements of its first mortgage or other bonds, in accordance with the provisions of the mortgage or deed of trust securing such bonds; all Federal, State, Municipal, and other taxes, charges, licenses, and assessments, now or hereafter lawfully imposed upon the Steam Company or for which it may in any manner be liable or chargeable on account of its corporate existence, its franchises, property, real or personal, business, earnings, bonds, capital stock, dividends or profits, and any sum which shall hereafter be levied or assessed on any shareholder of the Steam Company or upon its share by way of direct tax upon said share or the income thereof, which the Steam Company shall or may be required to pay on behalf of or retain from any such shareholder or bondholder; all fire, storm, lightning, accident, compensation, public liability, or other insurance premiums which the Steam Company may be required or deem advisable to carry; all legal expenses and other expenses whatsoever from time to time as the same may arise not otherwise specifically covered by the terms of this agreement. The intent and purpose of these provisions being that the Power Company shall at all times pay or provide for the payment of every obligation and expense of the Steam Company in order to enable

the latter to realize a net return of eight per cent. annually upon the par value of all of its securities at any time outstanding.

4. The Power Company shall make monthly cash settlements on the 20th day of each month for the accrued indebtedness of the preceding month.

5. This agreement shall continue until January 1, 1975.

64 6. In order to make necessary repairs or changes on its system, Steam Company shall have the right temporarily to discontinue service but except in cases of extreme emergency, at least twenty-four hours' notice shall be given by Steam Company that discontinuance of service is to take place.

7. It is agreed that neither of the parties hereto assumes any obligation inconsistent with any law of the Commonwealth of Pennsylvania now or hereafter in force, and that compliance by either party with any lawful order of any commission or other governmental body having jurisdiction in the premises shall in no event be deemed a breach of this contract.

8. The provisions hereof shall bind and enure to the benefit of the parties hereto and their respective successors and assigns.

IN WITNESS WHEREOF, the parties have caused these presents to be executed by their duly authorized officers and their corporate seals to be affixed, the day and year first above mentioned.

PENNSYLVANIA WATER AND POWER COMPANY.
By (Sgd.) CHARLES E. F. CLARKE, *President.*

Attest:

(Sgd.) F. J. ALLEN, *Secretary.*

Witnesses present:

(Sgd.) E. V. ILLMER.
(Sgd.) OTTO C. W. KOPPLEMANN.

65

HOLTWOOD POWER COMPANY.
By (Sgd.) KERSEY CARRIGAN,
President.

Attest:

(Sgd.) JOHN S. GRAYBILL, JR., *Secretary.*
(Sgd.) J. GUY ESHLEMAN.
(Sgd.) ALICE G. SAUER.

Exhibit No. 3 to stipulation

COPY OF APPLICABLE SECTIONS OF THE ACT OF THE COMMONWEALTH OF PENNSYLVANIA OF APRIL 29, 1874, AS AMENDED BY SECTION 5 OF THE ACT OF APRIL 17, 1876, AND THE ACT OF JUNE 2, 1915, UNDER WHICH THE "SHORT FORM OF MERGER" WAS CONSUMMATED

SECTION 18. The capital stock or indebtedness of any corporation to be created under the provisions of this statute, or accepting its provisions, may be increased, from time to time, by the consent of the

persons or bodies corporate holding the larger amount in value of the stock of such company, to such amount as such corporation is by this act authorized to increase its capital stock or indebtedness, but such increase shall only be made for money, labor done, or money or property actually received.

SECTION 19. Any such corporation desirous of increasing its capital stock or indebtedness as provided by this act, shall, by a resolution of its board of directors, call a meeting of its stockholders therefor, which meeting shall be held at its chief office or place of business in this commonwealth; and notice of the time, place, and object of said meeting, shall be published once a week for sixty days prior to such meeting, in at least one newspaper published in the county, city, or borough wherein such office or place of business is situate.

SECTION 20. At the meeting called, pursuant to the nineteenth section of this act, an election of the stockholders of such corporation shall be taken for or against such increase, which shall be conducted by three judges, stockholders of said corporation, appointed by the board of directors to hold said election, and if one or more of said judges be absent, the judge or judges present shall appoint a judge or judges, who shall act in the place of the judge or judges absent, and who shall respectively take and subscribe an oath or affirmation before an officer authorized by law to administer the same, well and truly, and according to law, to conduct such election to the best of their ability; and the said judges shall decide upon the qualification of voters, and when the election is closed count the number of shares voted for and against such increase, and declare whether the persons or bodies corporate holding the larger amount of the stock of such corporation have consented to such increase, or refused to consent thereto, and shall make out duplicate returns of said election, stating the number of shares of stock that voted for such increase and the number that voted against such increase, and subscribe and deliver the same to one of the chief officers of said company.

SECTION 21. Each ballot shall have endorsed thereon the number of shares thereby represented, and be signed by the holder thereof, or by the person holding a proxy therefor; but no share or shares transferred within sixty days shall entitle the holder or holders thereof to vote at such election or meeting, nor shall any proxy be received, or entitle the holder to vote, unless the same shall bear date and have been executed within three months next preceding such election or meeting; and it shall be the duty of such corporation to furnish the judges at said meeting with a statement of the amount of its capital stock, with the names of persons or bodies corporate holding the same, and number of shares by each respectively held, which statement shall be signed by one of the chief officers of such corporation, with an affidavit thereto annexed

that the same is true and correct to the best of his knowledge a belief.

SECTION 22. It shall be the duty of such corporation, if consent given to such increase, to file in the office of the secretary of the co monwealth, within thirty days after such election or meeting, of the copies of the return of such election provided for by twentieth section of this act, with a copy of the resolution and not calling same thereto annexed; and upon the increase of the capi stock or indebtedness of such corporation made pursuant thereto shall be the duty of the president or treasurer of such corporati within thirty days thereafter, to make a return to the secretary of commonwealth, under oath, of the amount of such increase and ter of the same, that is to say, the terms on which additional stock issued; and in case of neglect or omission so to do, the corporat shall be subject to a penalty of five thousand dollars, which pena shall be collected on an account settled by the auditor general state treasurer, as accounts for taxes due the commonwealth are sett and collected; and the secretary of the commonwealth shall ca said returns to be recorded in a book to be kept for that purpose. furnish a certified copy of the same to the auditor general, and corporation shall have the right to recover the same from the of neglecting or omitting to file the return as aforesaid.

68 SECTION 23. Any corporation created under the provisi of this act, and any corporation of the classes named in second section hereof, that is now in existence by virtue of any of this Commonwealth, may reduce its capital stock or alter change the par value of the shares thereof, by a vote of the st holders taken in the manner and under the regulations prescribed the eighteenth, nineteenth, twentieth, twenty-first, and twenty-sec sections of this act; and it shall be lawful for any corporation in same manner to sell, assign, dispose of, and convey to any corporat created under or accepting the provisions of this act, its franchi and all its property, real, personal, and mixed, and thereafter s corporation shall cease to exist, and the said property and franch not inconsistent with this act, shall thereafter be vested in the poration so purchasing as aforesaid: Provided, That the returns quired by said section shall not be filed in the office of the Secret of the Commonwealth until each and every corporation, so sell assigning, disposing, and conveying such franchises and prope shall have filed with the Secretary of the Commonwealth a certifi from the Auditor General of the Commonwealth, setting forth all reports required by the Auditor General of the Commonwe have been duly filed to the date of the proposed sale, assignm disposition, and conveyance; and that all taxes due the Comm wealth of Pennsylvania have been paid up to and including date. (Act of April 29, 1874, Section 23, as amended by Act April 17, 1876, Section 5, and Act of June 2, 1915.)

69 *Exhibit No. 4 to stipulation*

Copy of Long Form Merger Act of 1909

(Purdon's Pennsylvania Statutes, Title 15)

Section 421. Merger authorized; exceptions; exclusive franchise not extended; merger subject to act of 1907

It shall be lawful for any corporation, now or hereafter organized under the provisions of any general or special act of Assembly authorizing the formation of any corporation or corporations, to merge its corporate rights, franchises, powers, and privileges with and into those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation into which such merger shall be made: Provided, That nothing in this act shall be construed so as to permit railroad, canal, or telegraph companies, which own, operate, or in any way control, parallel or competing roads, canals, or lines, to merge or combine: Provided further, That nothing in this act contained shall extend or enlarge beyond its former territorial limits the exclusive franchise of any gas or water company; and that the merger or consolidation of water companies shall be subject to the provisions of the act, entitled "An act to require all water and water-power companies hereafter incorporated, or hereafter formed by merger and consolidation, or hereafter purchasing property and franchises of any other such company, to designate the exact source of their supply of water or water-power; and to require all existing water and water-power companies, merging and consolidating or purchasing the property and franchises of any other such company, to accept the provisions of this act, and of the act approved April thirteenth, one thousand nine hundred and five, entitled 'An act providing that the right of eminent domain, as represents the appropriation of streams, rivers, or waters, or the land covered thereby, shall not be exercised by water companies incorporated under law,' and providing the manner in which water and water-power companies, subject to the provisions of this act, may secure a new or additional source of supply for their water or water-power," approved the seventh day of June, Anno Domini one thousand nine hundred and seven. (1909, May 3, P. L. 68, Section 1.)

Section 422. Procedure; joint agreement; approval by stockholder; certificates; approval by governor

Said merger or consolidation shall be made under the conditions, provisions, and restrictions, and with the powers herein set forth; to wit—

First. The directors of each corporation shall enter into a joint agreement, under the corporate seal of each corporation, for the

merger and consolidation of said corporations; prescribing the terms and conditions thereof, the mode of carrying the same into effect, the name of the new corporation, the number and names of the directors and other officers thereof, and who shall be the first directors and officers, and their places of residence, the number of shares of the capital stock, the amount or par value of each share, and the manner of converting the capital stock of each of said corporations into the stock of the new corporation, and how and when directors and officers shall be chosen, with such other details as they shall
71 deem necessary to perfect the said consolidation and merger; but said agreement shall not be effective unless the same shall be approved by the stockholders of said corporations, in the manner hereinafter provided.

Second. Said agreement shall be submitted to the stockholders of each of said corporations, at separate special meetings or at any annual meetings, of the time, place, and object of which respective meetings due notice shall be given by publication, once a week for two consecutive weeks before said respective meetings, in at least one newspaper in the county or in each of the counties in which the principal office of said respective corporations shall be situate—excepting in the case of the merger or consolidation of corporations which, upon their original incorporation, are required by the Constitution to publish notice of intention to incorporate for a longer period than two weeks, in which case notice by publication shall be as required by the Constitution—and at said meetings the said agreement of the directors shall be considered, and a vote of the stockholders in person or by proxy shall be taken, by ballot, for the adoption or rejection of the same, each share of stock entitling the holder thereof to one vote; and if a majority in amount of the entire capital stock of each of said corporations shall vote in favor of said agreement, merger, and consolidation, then that fact shall be certified by the secretary of each corporation, under the corporate seal thereof, and said certificates, together with the said agreement or a copy thereof, shall be filed in the office of the Secretary of the Commonwealth, who shall forthwith present the same to the Governor for his approval, and when approved by the Governor the said agreement shall be deemed and taken to be the act of consolidation of said corporation. (1909, May 3, P. L. 408, Section 2.)

72 Section 423. Effect of merger; new patent, bonus, certificate of reports and payment of taxes

Upon the filing of said certificates and agreement, or copy of the agreement, in the office of the Secretary of the Commonwealth, and upon the issuing of new letters patent thereon by the Governor, the said merger shall be deemed to have taken place, and the said corporations to be one corporation under the name adopted in and by said agreement possessing all the rights, privileges, and franchises

theretofore vested in each of them; and all the estate and property, real and personal, and rights of action, of each of said corporations, shall be deemed and taken to be transferred to and vested in the said new corporation, without any further act or deed: Provided, That all rights of creditors and all liens upon the property of each of said corporations shall continue unimpaired, limited in lien to the property affected by such liens at the time of the creation of the same, and the respective constituent corporations may be deemed to be in existence to preserve the same; and all debts not of record, duties, and liabilities of each of said constituent corporations shall thenceforth attach to the said new corporation, and may be enforced against it to the same extent and by the same process as if said debts, duties, and liabilities had been contracted by it. But such merger and consolidation shall not be complete, and no such consolidated corporation shall do any business of any kind, until it shall have first obtained from the Governor of the Commonwealth new letters patent, and shall have paid to the State Treasurer a bonus, as prescribed by law, upon all its capital stock in excess of the amount of capital stock of the several corporations so consolidating, upon
73 which the bonus required by law has been theretofore paid:

And provided further, That new letters patent of such consolidated corporation shall not be issued by the Governor of the Commonwealth, until each corporation entering into and forming the consolidated corporation shall have filed with the Secretary of the Commonwealth a certificate from the Auditor General of the Commonwealth, setting forth that all reports required by the Auditor General of the Commonwealth have been duly filed to the date of the proposed merger, and that all taxes due the Commonwealth of Pennsylvania have been paid, up to and including said date. (1909, May 3, P. L. 408, Section 3; 1915, April 29, P. L. 205, Section 1.)

Section 424. Evidence of merger

A certified copy of said certificate and agreement, or copy of agreement, so to be filed in the office of the Secretary of the Commonwealth, shall be evidence of the lawful holding and action of such meetings, and of the merger and consolidation of said corporations. (1909, May 3, P. L. 408, Section 4.)

Section 425. Dissenting stockholders; appraisement of damages and value of stock; payment

If any stockholder or stockholders of any corporation, which shall become a party to an agreement of merger and consolidation hereunder, shall be dissatisfied with or object to such consolidation, and shall have voted against the same at the stockholder's meeting, it shall and may be lawful for any such stockholder or stockholders, within thirty days after the adoption of said agreement of merger and consolidation by the stockholders, as herein provided, and upon reasonable notice to said corporation, to apply by petition to any

court of common pleas of the county in which the chief
74 office of such corporation may be situate, or to a judge of said
court in vacation, if no such court sits during said period, to appoint three disinterested persons to estimate and appraise the damages, if any, done to such stockholder or stockholders by said consolidation. Upon such petition, it shall be the duty of a said court or judge to make such appointment; and the award of the persons so appointed, or of a majority of them, when confirmed by the said court shall be final and conclusive; and the persons so appointed shall also appraise the share or shares of said stockholders, in the said corporation, at the full market value thereof, without regard to any appreciation or depreciation in consequence of the said consolidation; which appraisement, when confirmed by the said court, shall be final and conclusive; and the said corporation may, at its election, either pay to the said stockholder or stockholders the amount of damages so found and awarded, if any, or the value of the stock so ascertained and upon the payment of the value of the stock, as aforesaid, the said stockholder or stockholders shall transfer the stock so held by them to the said corporation, to be disposed of by the directors thereof or to be retained for the benefit of the other stockholders; and in case the value of said stock, as aforesaid, shall not be so paid within thirty days after the said award shall have been confirmed by said court, the damages so found and confirmed shall be a judgment against said corporation, and may be collected as other judgments in said court are by law recoverable. (1909, May 3, P. L. 40 Section 5.)

75 Before United States Board of Tax Appeals

Agreement to statement of evidence under equity rule 75

We have examined and read the foregoing 24 pages comprising the evidence taken in the case of Pennsylvania Water & Power Company, Petitioner, v. Commissioner of Internal Revenue, Respondent Docket No. 56720, in the United States Board of Tax Appeals; said evidence being stated in simple and condensed form, all parts not essential to the decision of the questions presented by the petition for review being omitted. We agree that all parties hereto have received due and legal notice of said statement as required by Equity Rule No. 75, and we accept service of such notice and hereby waive further notice of the filing of the statement, and we agree that said statement as made may be approved by the Board Member hearing the case without further notice to any party hereto, and that when so approved may be filed in the Clerk's office and become a part of the record for the purpose of the petition for review in said cause filed by Pennsylvania Water & Power Company, Petitioner.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue,
Attorney for Respondent

Dated: December 29, 1937.

76 Before United States Board of Tax Appeals

Order approving statement of evidence

I hereby certify that the foregoing statement of evidence has been examined by me and found conformable to the truth and contains all the evidence in said case in condensed form, and the proceedings had upon the trial of said cause.

It further appearing to the Board that Exhibit No. 1, entitled "Agreement between Pennsylvania Water & Power Company and Holtwood Power Company," dated August 26, 1924, referred to in the statement of evidence and incorporated therein by reference, is only partially pertinent to the issue involved in this appeal, it is hereby ordered that the description of the property to be conveyed contained therein, be omitted in preparing the transcript of the record herein.

Said statement of evidence on the petition for review of Pennsylvania Water & Power Company is hereby approved, signed, and ordered to be made of record in the above entitled cause this thirtieth day of December 1937.

(Sgd.) ARTHUR J. MELLOTT,
Member, United States Board of Tax Appeals.

77 Before United States Board of Tax Appeals

Praecipe for transcript of record

Filed December 29, 1937

To the Clerk of the United States Board of Tax Appeals:

Please prepare a transcript of record in this cause, and on or before the nineteenth day of February 1938 transmit the same to the Clerk of the United States Circuit Court of Appeals for the Third Circuit, and include in said transcript copies, duly certified as correct, of the following documents:

1. Docket entries of proceedings before the Board in the above entitled cause;
2. Petition for redetermination, filed with the Board by petitioner on April 18, 1931;
3. Notice of deficiency, filed with petition, marked Exhibit "A";
4. Answer to petition, filed on October 17, 1931;
5. Opinion of the Board promulgated on August 24, 1937;
6. Decision of the Board entered on October 16, 1937;
7. Petition for review, filed December 22, 1937;
8. Statement of evidence, approved and filed;
9. This praecipe for transcript.

In addition to the foregoing documents, please include and transmit with the statement of evidence and transcript the following

exhibits filed in the Board with the Stipulation of Facts in this cau
pursuant to the Board's order on the statement of evidence:

78 No. 1. Agreement between petitioner and Holtwood Pow
Company, dated August 26, 1924, omitting description of pro
erty to be conveyed;

No. 3. Copy of sections of the Act of the Commonwealth of Pen
sylvania of April 29, 1874, as amended by Section 5 of the Act
April 17, 1876, and the Act of June 2, 1915, under which the "sho
form of merger" was consummated;

No. 4. Copy of the "Long Form Merger Act of 1909."

Said transcript to be prepared as required by law and the rul
of the United States Circuit Court of Appeals for the Third Circu

AGREEMENT OF PRAECIPE

We hereby agree that the above and foregoing praecipe is correc
that the records, documents, papers, and proceedings therein set for
are sufficient for a complete record in this cause on appeal, and
hereby adopt the foregoing as a list designated by each of the parti
to this cause to complete said transcript, and we hereby waive th
issuance and service of notice upon any party hereto, and agree th
said praecipe shall be obeyed by, and acted upon by, the Clerk
fully and to all intents and purposes as if said praecipe had be
regularly filed and a true copy thereof served upon each party here

CLYDE T. WARREN,
EDWIN M. STUETEVANT,
Attorneys for Petitioner.
J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.
Attorney for Respondent.

79 [Clerk's certificate to foregoing transcript omitted
printing.]

80 In United States Circuit Court of Appeals for the Third
Circuit

No. 6678. March Term, 1938

PENNSYLVANIA WATER AND POWER CO., PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Order assigning judge

Filed April 11, 1938

And now, to-wit: this 11th day of April, A. D. 1938, it is order
that Hon. Oliver B. Dickinson, District Judge for the Eastern D

trict of Pennsylvania, be, and he is hereby, assigned to sit in above case in order to make a full court.

JOSEPH BUFFINGTON,
Circuit Judge.

[File endorsement omitted.]

In United States Circuit Court of Appeals for the Third Circuit

[Title omitted.]

Minute entry of argument

And afterwards, to wit, the 11th day of April 1938, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable J. Warren Davis and Honorable John Biggs, Jr., Circuit Judges, and Honorable Oliver B. Dickinson, District Judge, and the Court not being fully advised in the premises, takes further time for the consideration thereof.

And afterwards, to wit, on the 23d day of August 1938, come the parties aforesaid by their counsel aforesaid, and the Court, now being fully advised in the premises, renders the following decision:

In United States Circuit Court of Appeals, for the Third Circuit

No. 6678. March Term, 1938

PENNSYLVANIA WATER AND POWER COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review from the United States Board of Tax Appeals

Opinion

Filed August 23, 1938

Before DAVIS and BIGGS, Circuit Judges, and DICKINSON, District Judge.

DAVIS, Circuit Judge. The sole question here at issue is whether or not a parent corporation, having taken over the assets of its subsidiary corporation under the provisions of the so-called "short form merger statute" of Pennsylvania (Purdon's Pennsylvania Statutes, Title 15, Section 595), and thereafter, in 1928, having redeemed for cash bonds issued by the subsidiary, is entitled to deduct from its income tax return for that year the amount of the unamortized discount and expenses connected with the issuance of the bonds.

In the case of Metropolitan Edison Company v. Commissioner, which we are filing with this opinion, we held that the deduction was allowable. The decision in that case is applicable to the facts in this case.

Prior to October 4, 1927, the petitioner was authorized by
charter: (1) to store, transport and supply water, and (2) to p
duce and sell electricity generated by water power. It was inform
however, that it lacked the power to generate electricity by means
steam. At various times of the year, such as, when the river w
blocked by ice or the water was low, the petitioner's hydroelect
plant was incapable of producing sufficient electricity for its nee

In order to have on hand an added source of electrical power d
ing those periods, it formed the Holtwood Company, hereinaf
referred to as Holtwood, for the purpose of owning and operati
a steam power plant. Holtwood and the petitioner thereupon ente
into a contract under the terms of which the petitioner agreed
convey to Holtwood a tract of land adjacent petitioner's hydroel
tric plant, and Holtwood agreed to erect thereon a steam power pl
according to specifications acceptable to the petitioner. Holtwo
also contracted to sell to the petitioner all of the electricity produc
at such plant, in consideration of which the petitioner promised
pay as follows:

"* * * any and all sums necessary for the purpose of defrayi
the expenses of maintaining the corporate organization of the Ste
Company; the expenses attending the issuing, registration, and tra
fer of the capital stock and bonds of the Steam Company, now
hereafter issued and outstanding, and all interest on its bonded
other indebtedness at any time outstanding or existing, as and wh
said several interest payments may become due and payable; sinki
fund requirements of its first mortgage or other bonds, in
84 cordance with the provisions of the mortgage or deed of tr
securing such bonds; all Federal, State, Municipal and oth
taxes, charges, licenses, and assessments, now or hereafter lawfu
imposed upon the Steam Company or for which it may in any ma
ner be liable or chargeable on account of its corporate existence,
franchises, property, real or personal, business, earnings, bonds, c
ital stock, dividends or profits, and any sum which shall hereafter
levied or assessed on any shareholder of the Steam Company or up
its share by way of direct tax upon said share or the income there
which the Steam Company shall or may be required to pay on beh
of or retain from any such shareholder or bondholder; all fire, stor
lightning, accident, compensation, public liability, or other insura
premiums which the Steam Company may be required or deem adv
able to carry; all legal expenses and other expenses whatsoever fr
time to time as the same may arise not otherwise specifically cove
by the terms of this agreement. The intent and purpose of th
provisions being that the Power Company shall at all times pay
provide for the payment of every obligation and expense of t
Steam Company in order to enable the latter to realize a net retu
of eight per cent. annually upon the par value of all of its securit
at any time outstanding."

Holtwood issued 15,000 shares of capital stock, 14,950 of whi
were purchased by the petitioner in its own name. The petitio

also acquired equitable title to the remaining 50 shares, but they were placed in the names of other persons to qualify them as directors. Holtwood also issued bonds to the amount of $2,750,000. The discount on these bonds amounted to $137,500 and the expenses connected with the issue totaled $25,249.87. With the proceeds of the sale of all of its stock and bonds, Holtwood erected the steam power plant as agreed.

This plant was operated only during those periods when the
85 petitioner's hydroelectric plant could not produce sufficient electric power to supply its needs, and then it was operated by the petitioner, as Holtwood employed no men for this purpose. The officers and directors of the petitioner were made the officers and directors of Holtwood and all of the compensation received by them came from the petitioner.

The provision in the petitioner's charter empowering it to store, transport and supply water, was held to be a bar to a merger between the two companies. On June 6, 1926, the Supreme Court of Pennsylvania in the case of York Haven Water & Power Co. v. Public Service Commission (287 Pa. 241, 134 Atl. 419), under similar facts, held that if the power to supply water was legally abandoned, the merger could take place. In accordance with this decision, on October 4, 1927, the petitioner surrendered this power and shortly thereafter in 1927 it took over all of the assets of Holtwood under the "short form merger statute" of Pennsylvania. Under this statute, Holtwood conveyed all of its assets to the petitioner and the petitioner returned to Holtwood all of its stock and assumed all of its liabilities.

In 1928, the petitioner redeemed for cash all of the outstanding bonds issued by Holtwood. At that time there was $144,255.10 of the bond discount and issuing expenses still unamortized. In its income-tax return for that year, the petitioner deducted that amount. The commissioner, however, disallowed this deduction and determined a deficiency of $16,575.82. The United States Board of Tax Appeals sustained the commissioner's determination and the petitioner appealed to this court.

The sole question at issue is whether or not the petitioner was entitled to the deduction. This question depends upon whether or not the method by which the petitioner took over the assets of
86 Holtwood amounted to a merger or to a sale. If the transaction was a merger, the deduction should have been allowed. If it was a sale, it should not have been allowed.

As stated above, the decision in Metropolitan Edison Company v. Commissioner, supra, controls this case and the order of redetermination is set aside and the case remanded to the Board with directions to allow the deduction.

A true Copy:
Teste:

Clerk of the United States Circuit Court
of Appeals for the Third Circuit.

87 In United States Circuit Court of Appeals for the Third Circuit

No. 6678. March Term, 1938

PENNSYLVANIA WATER & POWER CO., PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Judgment

Filed August 23, 1938

Appeal from the United States Board of Tax Appeals.

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the order or decree of the said Board of Tax Appeals in this cause be, and the same is hereby reversed, with directions to the said Board of Tax Appeals to redetermine the tax of the petitioner in accordance with the opinion of this Court.

Philadelphia, August 23, 1938.

J. WARREN DAVIS,
Circuit Judge.

[File endorsement omitted.]

88 [Clerk's Certificate to foregoing transcript omitted in printing.]

89 Supreme Court of the United States

Order allowing certiorari

Filed January 3, 1939

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover:] File No. 42971, 42972. U. S. Circuit Court of Appeals, Third Circuit. Term No. 487. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner vs. Pennsylvania Water & Power Company. Petition for writs of certiorari and exhibits thereto. Filed November 23, 1938. Term No. 486 O. T. 1938, 487 O. T. 1938.

U. S. GOVERNMENT PRINTING OFFICE 19